

# NEW YORK CITY FINANCIAL CRISIS

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## HEARINGS BEFORE THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-FOURTH CONGRESS

FIRST SESSION

ON

**S. 1833, S. 1862, S. 2372, S. 2514,  
and S. 2523**

TO FURNISH LOAN GUARANTIES TO MUNICIPALITIES SUFFERING FINANCIAL ADVERSITIES TO ENABLE THEM TO ACHIEVE FISCAL BALANCE AND FINANCIAL HEALTH AT MINIMUM COST AND DISRUPTION TO THE NATION

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OCTOBER 9, 10, 18, AND 23, 1975

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# NEW YORK CITY FINANCIAL CRISIS

THURSDAY, OCTOBER 9, 1974

U.S. SENATE,  
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS,  
*Washington, D.C.*

The committee met at 9:45 a.m. in room 1202, Dirksen Senate Office Building, Senator William Proxmire, chairman of the committee, presiding.

Present: Senators Proxmire, McIntyre, Tower, Brooke, Packwood, and Garn.

Also present: Senator Abraham Ribicoff.

## STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. The committee will come to order. Today we begin hearings on whether to provide financial assistance to cities and other State and local government units on the edge of bankruptcy, and if so, how much? That's our issue. It's not an easy one to decide. But we have to resolve it. We can't duck it.

There's no way we can avoid deciding, and in the very near future—6 weeks at the outside—whether to provide Federal aid to State and local government units in trouble. New York City, the Nation's biggest city and financial center, the world's financial center in fact, is close to bankruptcy for us to duck the issue and hope it goes away. A prompt decision—up or down—is essential to settle the issue and clear the air, as Chairman Burns said in a statement before the Joint Economic Committee yesterday. The municipal bond market has suffered seriously in the past 2 weeks because of the uncertainty. We need a prompt decision.

We have to decide whether the Federal Government should aid New York City or let it default. No informed observer believes the city can continue to service its debt and pay its other creditors without Federal help.

Let me outline very briefly the specific questions which the committee must answer. First, we have to find out what will happen in the event of default. What are the likely consequences and costs? No one knows—or can know—for sure. Default by New York City won't necessarily be a calamity. Maybe the economic recovery now under way will be unaffected. Conceivably there won't be any serious disruptions in financial markets and the ability of other local government units to sell and service debt will not be seriously impaired. Perhaps the Nation's banks will be virtually unscathed and continue to function smoothly in channeling credit to investors. Possibly vital city services will not be interrupted, only waste removed from its budget.

and New York could even emerge from bankruptcy with a manageable debt structure.

Maybe. Conceivably. Perhaps. Possibly. But maybe not. Maybe default will leave the municipal securities market in shambles for months, even years, disrupt other financial markets, threaten the solvency of large numbers of banks throughout the country, and depress economic activity and employment in New York and elsewhere. Our first question in these hearings will be to make a judgment as to what will happen if New York defaults.

Second, the committee must weigh the costs and benefits of Federal credit assistance to State and local governments. The benefits of a Federal guarantee to New York City are threefold.

First, the U.S. Treasury itself can make money on a Federal guarantee if New York is required to issue taxable bonds as a condition for obtaining a guarantee. By taking tax-exempt issues off the market, I estimate the Treasury would gain \$25 million a year in additional tax revenues for every billion dollars of bonds guaranteed. Also, a guarantee fee of 1 percent would pick up an additional \$10 million a year in revenue for the Treasury for every billion dollars guaranteed.

Second, by preventing a default and the potential ripple effect on the municipal bond market, a Federal guarantee can help hold down interest rates on municipal bonds and prevent property tax increases from being imposed on taxpayers all across the country which otherwise might be necessary to meet the higher cost of servicing municipal debt.

Third, the prevention of a New York default will help obviate ripple effects in other capital markets and in our banking system. There are some who fear that these effects could impair our economic recovery and perpetuate our present high rate of unemployment.

Against these benefits, we must weigh the costs. The most obvious cost is, of course, the price of a subsequent default by New York City in which case Uncle Sam would be left holding the bag. These risks can be reduced if we insist that any guarantee be collateralized with future revenue sharing payments.

A second cost is the danger that a Federal guarantee might weaken the resolve of New York City to put its own fiscal house in order. Again, these risks can be reduced if stringent controls are imposed by those who administer the guarantee. This means insuring with no and's, if's, or but's that New York City be required to balance its budget within 2 or 3 years.

A third cost is the danger that a Federal guarantee would undermine the incentive for sound management on the part of other cities and invite similar requests for Federal assistance. Once again, these costs can be reduced if the Federal guarantee program establishes stringent preconditions so that future applicants will be discouraged except in truly emergency situations. Further discussion is needed if States are to be required to impose a tax sufficient to cover half or perhaps all of the city's operating deficit and thus make a balanced budget a prompt reality at a clear and painful sacrifice to the States.

The incentive for prudent management may be further reinforced if the investors in New York City obligations are required to bear some loss. Even a slight loss will make municipal bond investors more quality conscious in the future and thus provide cities with a strengthened

incentive to improve their municipal bond rating. Future investors must understand that high yielding securities carry risks which they and they alone must bear.

The hearings we begin today will bring these questions into focus and enable us to decide what actions, if any, the committee should recommend that the Senate take to furnish loans, guarantees, or other financial assistance to New York and other cities and States in financial difficulties which are beyond their capacities to cope with.

Our first witness will be Senator Jackson, of Washington. He will be followed by Senator Javits and Senator Humphrey. Each of these colleagues of ours has introduced legislation to resolve the crisis. Senator Bentsen has also introduced such legislation. He is unable to be here today.

After hearing from my distinguished colleagues, we will hear from Mr. Lennox Moak and William Simon, Secretary of the Treasury. The witness list for tomorrow is available in the committee's office. The list for the 18th will be made available as soon as it is ready.

[The bills being considered follow:]

[S. 1833, 94th Cong., 1st sess.]

A BILL To authorize emergency loan guarantees to units of government

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

#### FINDINGS AND PURPOSE

SECTION 1. (a) The Congress finds that—

(1) State and local governments suffer during recessionary periods from an extraordinary combination of rising costs, deteriorating tax bases, and tight money;

(2) in their duty to continue to provide needed services to the public, such units of government are forced to borrow increased amounts of funds in the capital markets;

(3) in extreme cases this situation impairs the ability of some units of government to enter the Nation's capital markets and to finance needed services;

(4) the deterioration of the financial condition of State and local government reflects directly upon the economic condition of the country as a whole and the the ability of this country to provide maximum production, employment and purchasing power; and

(5) the existence of a loan guarantee authority in the Federal Government is necessary in the national interest to enable such units of government to maintain a sound fiscal structure during temporary, recessionary periods.

(b) It is the purpose of this Act to provide authority for emergency financial assistance in the form of loan guarantees to aid units of government to meet temporary and urgent financial requirements which, if not met, might seriously impair the ability of such governments to provide needed services to the public, and might seriously affect the economy of the Nation or a region thereof.

#### DEFINITIONS

SEC. 2. As used in this Act—

(1) The term "unit of government" means the government of a municipality, township, or other unit of government below the State or county level which is a unit of general government which has a population in excess of one hundred thousand (determined on the basis of the same principles as are used by the Bureau of the Census for general statistical purposes); and

(2) The term "Secretary" means the Secretary of the Treasury.

#### EMERGENCY LOAN GUARANTEE AUTHORITY

SEC. 3. (a) In furtherance of the purpose of this Act, the Secretary is authorized upon terms and conditions prescribed by him, and after consulting with the

chairmen and ranking minority members of the Committee on Banking, Housing and Urban Affairs of the Senate and the Committee on Banking, Currency and Housing of the House of Representatives to make commitments to guarantee and to guarantee any financing institution against loss of principal or interest on any loan to a unit of government for the purpose of assisting that unit of government to meet temporary and urgent financial needs which if not met (1) could seriously impair the ability of the unit of government to provide services for the public, and (2) could adversely and seriously affect the economy of the region surrounding the unit of government.

(b) No guarantee of a loan shall be made under this section unless the Secretary finds and appropriately certifies that—

- (1) the loan is necessary to carry out the purpose of this Act ;
- (2) the loan is not otherwise available on reasonable terms and conditions from any source, public or private ;
- (3) there is reasonable assurance of repayment of the loan ;
- (4) a failure to provide a guarantee of the loan under the authority of this section would seriously impair the ability to produce the goods and services of the enterprise in behalf of which the guarantee is to be made ; and
- (5) the loan to be guaranteed will be applied to productive purposes which are necessary to the economic health and welfare of the Nation or a region thereof.

(c) The Secretary shall require such security for guarantees and such agreements regarding management of the components of the unit of government to be assisted as he may deem appropriate. At a minimum, the Secretary shall require any unit of government receiving a guarantee under this Act to develop a program for achieving a balanced budget financed by recurring revenues, and a program of long-range planning sufficient to insure the expectation of balanced budgets in the future.

(d) The Secretary shall consult, as necessary, with any unit of government which has received a loan guaranteed under this section concerning any matter which may bear upon the ability of the unit of government to repay the loan within the time fixed therefor and reasonable protection to the United States.

(e) (1) The maximum obligation of the Secretary under any loan or loans made to any one borrower within any one year which is guaranteed under this section shall not exceed \$500,000,000 unless—

(A) prior to making such guarantee the Secretary submits to the Congress a full and detailed report of the circumstances requiring the guarantee and the justification therefor in furtherance of the purposes of this Act ; and

(B) a period of thirty calendar days of continuous session of the Congress following the date on which such report is submitted to the Congress elapses, and during such period there is not passed by either the Senate or the House of Representatives a resolution stating in substance that the Senate or the House of Representatives, as the case may be, does not approve the proposed guarantee.

For the purposes of paragraph (B), in the computation of the thirty-day period there shall be excluded the days on which either the Senate or the House of Representatives is not in session because of adjournment of more than three days to a day certain or an adjournment of the Congress sine die.

(2) The maximum obligation of the Secretary under all outstanding loans guaranteed under this section shall not exceed at any time \$5,000,000,000.

(f) (1) Payments required to be made as a consequence of any guarantee under this section shall be made by the Secretary from the loan guarantee fund established pursuant to subsection (g).

(2) In the event of any default on any loan guaranteed under this section and payment in accordance with the guarantee is made by the Secretary, the Attorney General shall take such action as may be appropriate to recover the amount paid by the Secretary, with interest, from the defaulting borrower.

(3) The Secretary shall prescribe and collect a guarantee fee in connection with each loan guaranteed under this Act. Sums realized from such fees shall be deposited in the loan guarantee fund established pursuant to subsection (g).

(g) (1) There is established in the Treasury a loan guarantee fund to be administered by the Secretary. The fund shall be used only for the purpose of the guarantee program authorized by this section, including the payment of administrative expenses. All fees paid in connection with such program shall be credited to the fund. Moneys in the fund not needed for current operations

may be invested in bonds or other obligations of, or guaranteed by, the United States.

(2) There are authorized to be appropriated to the loan guarantee fund such amounts as may be necessary to provide requisite capital. In the event there are insufficient moneys in the fund to meet obligations of the fund, the Secretary shall transfer to the fund such sums as may be necessary to fulfill such obligations. The Secretary may use, for the purpose of making any such transfer, the proceeds from the sale of any securities issued under the Second Liberty Bond Act are extended to include such transfers to the fund. There are authorized to be appropriated to the Secretary of the Treasury such sums as may be necessary to repay such transfers. Interest on sums so transferred shall be paid from time to time, at a rate determined by the Secretary, from fees credited to the fund.

(h) There is created a Loan Guarantee Policy Board which shall consist of a chairman appointed by the President, with the advice and consent of the Senate, and the Chairman of the Federal Reserve Board and the Secretary of the Treasury as members. The Board shall establish general policies (particularly with respect to the national or regional economic interest involved in the granting or denial of applications for guarantees under this section and with respect to the coordination of the functions of the Secretary under this section with other activities and policies of the Government) which shall govern the granting or denial of applications for guarantees under this section.

(i) Any Federal Reserve bank is authorized to act as fiscal agent of the Secretary in the making of contracts of guarantee under this section and in otherwise carrying out the purposes of this section. All funds necessary to enable any such fiscal agent to carry out any guarantee made by it on behalf of the Secretary shall be supplied and disbursed by or under authority from the Secretary. No such fiscal agent shall have any responsibility or accountability except as agent in taking any action pursuant to or under authority of the provisions of this section. Each such fiscal agent shall be reimbursed by the Secretary for all expenses and losses incurred by it in acting as agent on behalf of the Secretary, including (without being limited to) the expenses of litigation.

(j)(1) Except as provided in paragraphs (2) and (3) of this subsection, this section and all authority conferred thereunder shall terminate upon the expiration of one year after the date of enactment of this Act, or upon the establishment of an Emergency Loan Guarantee Corporation pursuant to section 4, whichever is the earlier.

(2) If, upon the expiration of one year after the date of enactment of this Act action on the Emergency Loan Guarantee Corporation is pending before the Congress, the authority conferred under this section shall continue until such action is completed or upon the establishment of the Corporation, whichever is the earlier.

(3) The termination of this section and the authority conferred thereunder shall not affect the disbursement of funds under, or the carrying out of, any contract, guarantee, commitment, or other obligation entered into pursuant to this section prior to such termination, or the taking of any action necessary to preserve or protect the interests of the United States in any amounts advanced or paid out pursuant to this section.

#### REPORT; ESTABLISHMENT OF EMERGENCY LOAN GUARANTEE CORPORATION

SEC. 4. Not later than one year after the date of enactment of this Act, the Secretary shall submit to the Congress a full and complete report of his operations under section 3, together with his recommendations with respect to the need for the establishment of an Emergency Loan Guarantee Corporation to provide for the continuation of a loan guarantee assistance program comparable to that authorized under section 3. If the Secretary recommends the establishment of such Corporation, he shall, at the time of submitting such report or at any time thereafter but prior to the expiration of one year after the date of enactment of this Act, submit to the Congress a charter for the organization of such Corporation. Such charter shall take effect, and the Emergency Loan Guarantee Corporation shall become a body corporate with the powers stated in such charter, upon the expiration of the first period of sixty calendar days of continuous session of the Congress following the date on which the charter is transmitted to the Congress, if between the date of transmittal and the expiration of such sixty-day period there has not been passed by either the Senate or the House of Representatives a resolution stating in substance that

it does not approve the proposed charter or the establishment of the proposed Corporation. For the purpose of the foregoing, there shall be excluded, in the computation of such sixty-day period, the days on which either the Senate or the House of Representatives is not in session because of adjournment of more than three days to a day certain or an adjournment of the Congress sine die.

PROCEDURES WITH RESPECT TO DISAPPROVAL RESOLUTIONS

SEC. 5. The provisions of sections 910 through 913 of title 5, United States Code, shall be applicable with respect to the procedure to be followed in the Senate and House of Representatives in the exercise of their respective responsibilities under sections 3(e) and 4 of this Act, except that references in such provisions to a "resolution with respect to a reorganization plan" shall be deemed for the purposes of this section to refer to a resolution of disapproval under sections 3(e) and 4.

[S. 1862, 94th Cong., 1st sess.]

A BILL To amend the Federal Financing Bank Act of 1973 to provide funds to general units of local government in financial distress

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

SECTION 1. Section 3 of the Federal Financing Bank Act of 1973 is amended by adding at the end thereof the following:

"(5) The term 'unit of local government' means a county, municipality, city, town, township, or other unit of general local government."

SEC. 2. Section 6 of the Federal Financing Bank Act of 1973 is amended by adding at the end thereof the following:

"(d) In addition, the Bank shall purchase general obligation bonds which are issued by a unit of local government if—

"(1) the maturity of such obligations does not exceed two years;

"(2) the unit of local government issuing such obligations for purchase by the Bank provides such assurances as the Secretary of Housing and Urban Development deem necessary that such unit of local government has made a bona fide attempt without success to obtain such funds at reasonable terms from private sources, State sources, or general offerings to the public;

"(3) the unit of local government has submitted to the Secretary of Housing and Urban Development a comprehensive plan of fiscal and budgetary expenditures and controls to achieve a balanced budget and which will, to the satisfaction of the Secretary, permit the full retirement of any such obligation within two years; and

"(4) the proceeds of any issue of obligations purchased under this subsection will not be utilized for construction or for any purpose other than the satisfaction of liabilities already incurred.

The aggregate amount of obligations purchased under this subsection may not exceed \$3,000,000,000."

[S. 2372, 94th Cong., 1st sess.]

A BILL To secure fair financing for local units of government

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That this Act may be cited as the "Fair Financing for Local Government Act of 1975".

FINDINGS AND DECLARATION OF PURPOSE

SEC. 2. (a) The Congress finds that—

(1) Interest rates on local government bonds have now risen to levels at which a significant portion of local tax revenues is consumed servicing debt rather than in improving the delivery and quality of essential public services; and

(2) Capital funds must be available at reasonable rates if the essential services provided by local government are to be maintained.

(b) It is the purpose of this Act to reduce the cost of government at the local level by lowering interest rates, and to expand the market for municipal securities issued by cities with balanced budget programs.

## DEFINITIONS

## SEC. 3. As used in this Act—

(1) The term "State" means the several States, the District of Columbia, and the Commonwealth of Puerto Rico.

(2) The term "unit of local government" means any public corporate body, political subdivision, public agency or other instrumentality established under the laws of any State with authority to issue securities.

(3) The term "municipal bond" means any bond issued by a unit of local government, or any agency or instrumentality of a unit of local government, but does not include any bond issued in order to raise funds for any industrial or commercial facility for private use, by lease, conditional or installment sales contract, or other means of transfer, where such facility is or will be used primarily for the mining, manufacturing, assembling, fabricating, storing, processing, or sale of articles or commodities.

(4) The term "insurer" means any insurance company, or group of companies under common ownership, or any pool or association of insurance companies, which is authorized to engage in the insurance business under the laws of any State.

(5) The term "State local assistance agency" means any corporation, board, agency or other instrumentality which issues its own obligations and uses the proceeds thereof to purchase bond issues of units of local government within that State, whether or not such State guarantees the payment of the obligations of such State local assistance agency.

## TITLE I—FAIR FINANCE INSURANCE BOARD

## ESTABLISHMENT OF BOARD

Sec. 101. There is hereby established a Fair Finance Insurance Board (hereinafter "the Board"). The Board shall have its principal offices in the District of Columbia and shall be deemed, for purposes of venue in civil actions, to be a resident thereof. The Board may establish offices in such other places as it deems necessary in the conduct of its business.

## MEMBERS AND PERSONNEL

Sec. 102. (a) (1) The Board shall consist of a Chairman and four members appointed by the President, by and with the advice and consent of the Senate. The Chairman and the members of the Board shall be persons who, as a result of their training, experience and attainments, in academia, the labor movement, commerce and/or government, are exceptionally well qualified to formulate and carry out the purposes of this Act. Appointments of the Chairman and members pursuant to this subsection shall be made in a manner such that not more than three members of the Board including the Chairman shall be members of the same political party. The Chairman and each member shall serve for a term of five years, except that of the Chairman and members first appointed to the Board; one shall serve for one year, one for two years, one for three years, one for four years, and one for five years, to be designated by the President at the time of appointment.

(2) In addition to the members appointed by the President, the Secretary of the Treasury and the Secretary of Housing and Urban Development shall serve as nonvoting members of the Board *ex-officio*.

(b) the Board shall meet at the call of the Chairman which shall be not less often than four times per year.

(c) *Ex officio* members of the Board shall not be compensated for their services.

(d) Subject to such rules as may be adopted by the Board, the Chairman may appoint and fix the salary of such personnel as may be necessary for the conduct of the business of the Board, in accordance with the provisions of title 5, United States Code, governing appointment in the competitive service, and chapter 51 and subchapter III of chapter 53 of such title relating to classification and general schedule pay rates, and to obtain the services of experts and consultants in accordance with section 3109 of title 5, United States Code, at rates for individuals not to exceed the per diem equivalent for GS-18.

(e) The members of the Board, other than *ex officio* members, shall receive compensation as prescribed for offices and positions at level II of the Executive Schedule (5 U.S.C. 5312). The members of the Board, other than *ex officio* members, shall not—

(1) have any financial interest or relationship, direct or indirect, with any person engaged in the issuance, sale, distribution or rating of municipal bonds;

(2) after his service on the Board has ended, represent anyone other than the United States in connection with a matter in which the Board is a party or has an interest and in which he participates personally and substantially for the Board; or

(3) receive any emoluments, salary, or supplementation of his Government salary, from a private source as compensation for his services to the Board.

(g) There shall be a General Counsel to the Board who shall be appointed by the Board and who shall receive compensation at the rate prescribed for offices and positions at level III of the Executive Schedule (5 U.S.C. 5314).

#### GENERAL POWERS OF THE BOARD

SEC. 103. (a) For the purpose of carrying out its functions under this Act, the Board shall have the power—

(1) to have a seal which may be altered at pleasure and to use the same by causing it, or a facsimile thereof, to be impressed or affixed or in any other manner reproduced;

(2) to sue and be sued;

(3) to enter into and perform contracts, leases, cooperative agreements, and other transactions, on such terms as the Board shall deem appropriate, and to consent to modification thereof, without regard to sections 3648 and 3709 of the Revised Statutes, as amended (31 U.S.C. 529; 71 U.S.C. 5), and section 322 of the Act of June 30, 1932, as amended (40 U.S.C. 278a);

(4) to issue such rules and regulations as may be deemed necessary or appropriate to carry out the purposes of this Act;

(5) to exercise all power specifically granted by this Act and such incidental powers as are necessary to carry out the purposes of this Act.

(b) All suits of a civil nature at common law or in equity to which the Board shall be a party shall be deemed to arise under the laws of the United States, except that no attachment, garnishment, or other similar process shall be issued against the Board or its property.

(c) The Board is authorized to secure directly from any executive department or agency information, estimates, statistics, and technical assistance for the purpose of carrying out its functions under this Act. Each such executive department or agency shall furnish the information, estimates, statistics, and technical assistance directly to the Board upon its request.

(d) On request of the Board, the head of any executive department or agency may detail, with or without reimbursement, any of its personnel to assist the Board in carrying out its functions under this section.

#### FINALITY OF CERTAIN FINANCIAL TRANSACTIONS

SEC. 104. Notwithstanding the provisions of any other law, any financial transaction authorized under this Act shall be final and conclusive upon all officers of the United States.

#### TAXATION

SEC. 105. The Board, including its reserves, surplus, and income shall be exempt from all taxation now or hereafter imposed by the United States, or by any State, or any subdivision thereof, except any real property acquired by the Board shall be subject to taxation by any State or political subdivision thereof, to the same extent, according to its value as other real property is taxed.

#### GOVERNMENT CORPORATION CONTROL ACT

SEC. 106. Section 101 of the Government Corporation Control Act is amended by inserting after "Pension Benefit Guarantee Corporation" the following: "Fair Finance Insurance Board."

### TITLE II—FUNCTIONS OF THE BOARD

#### REINSURANCE OF MUNICIPAL BONDS

SEC. 201. The Board is authorized to offer to any insurers, subject to the conditions hereinafter set forth, reinsurance against 75 per centum of losses result-

ing from the failure of any unit of local government to pay all or any part of scheduled municipal bond principal and interest payments on insured municipal bonds as such payments become due and payable.

SEC. 202. The Board is authorized to enter into any contract, agreement, or other arrangement with any insurer for reinsurance coverage, pursuant to section 201 hereof, in consideration of payment to the Board by the insurer of a premium which shall be determined by the Board, but which shall not exceed 1 per centum of the total amount of the interest and principal amounts insured.

#### CONDITIONS OF REINSURANCE

SEC. 203. The Board shall not enter into any contract or agreement to provide reinsurance to any insurer under this Act unless the Board shall determine that the assets of the insurer are sufficient to meet the obligations incurred by it under its contract with the issuer, pursuant to standards and procedures to be established by the Board of Directors.

#### GUARANTEE OF STATE LOCAL ASSISTANCE BONDS

SEC. 204. The Board is authorized to offer to the State local assistance agency of any State, subject to the conditions hereinafter set forth, a guarantee of payment of 75 per centum of the total amount of the interest and principal of bonds issued by such agency for the purpose of purchasing municipal bonds issued by a unit of local government within such State.

SEC. 205. The Board is authorized to issue a guarantee of the bonds of a State local assistance agency, pursuant to section 204 hereof, in consideration of payment to the Board, of a fee which shall be determined by the Board, but which shall not exceed 1 per centum of the total amount of the interest and principal of said bonds.

SEC. 206. No guarantee shall be issued by the Board under this Act unless—  
(a) The Board determines that the amortization provisions of the bond of the State local assistance agency are not in excess of its debt-paying capacity;

(b) The Board determines that the State local assistance agency:

(1) Prescribes and enforces standards and procedures for accounting and financial control, by local governments whose bonds are guaranteed, which are in accordance with generally accepted accounting principles;

(2) Requires that local governments whose bonds are guaranteed adopt a sound program for achieving a balanced budget financed by recurring revenues;

(3) Conducts sufficient periodic audit and oversight activities to insure the adherence to prescribed standards, procedures and principles by local governments whose bonds are guaranteed.

### TITLE III—SPECIAL STUDY AND ANNUAL REPORTS

#### LOCAL SECURITIES MARKET STUDY

SEC. 301. The Board shall conduct a study of the market for securities issued by units of local government, and shall include as subjects of concern in such study—

(1) The availability, and present and potential sources of funds for the purchase of such securities;

(2) Influences upon, and developments in, interest rates for such securities;

(3) Suggested reforms in the financial structures and functioning, and in present methods of financing the activities of, units of local government.

(4) Federal and State efforts to assist in the marketing of such securities.

SEC. 302. The Board shall submit such local securities market study to the President for transmission to the Congress no later than one hundred and eighty days subsequent to the enactment of this Act.

SEC. 303. The Board shall submit to the President for transmission to the Congress a comprehensive annual report of its activities under this Act.

### TITLE IV—ADVISORY COMMITTEES

#### LOCAL GOVERNMENT ADVISORY COMMITTEES

SEC. 401. (a) The Board is authorized to establish special advisory committees which shall consult with the Board during the planning and imple-

mentation of its functions and shall provide advice and information to the Board concerning all aspects of its activities.

(b) The advisory committees shall provide for the representation of the following interests and such other interests as the Board may deem necessary or desirable:

- (1) city, county and State governments;
- (2) the labor movement; and
- (3) the financial community.

(c) The advisory committees authorized by this section and such other advisory boards, committees, and councils as may be established by the Board shall be subject to the provisions of the Federal Advisory Committee Act (86 Stat. 770, title 5 App. U.S.C.).

#### TITLE V—FAIR FINANCE INSURANCE FUND

Sec. 501. (a) To carry out the reinsurance and guarantee programs authorized by this Act, there shall be established in the Treasury of the United States a Fair Finance Insurance Fund (hereinafter "the Fund") which shall be available, without fiscal year limitations:

(1) to make such payments as may, from time to time, be required under reinsurance or guarantee agreements entered into under this Act; and

(2) to pay such administrative expenses as may be necessary or appropriate to carry out the purposes of this Act.

(b) The Fund shall be credited with:

(1) Premiums for reinsurance contracts and fees for guarantee contracts which may be collected under the provisions of this Act;

(2) Such funds as may be advanced to the Fund from appropriations in order to maintain the Fund in an operative condition adequate to meet its liabilities;

(3) Interest which may be earned on investments of the Fund pursuant to subsection 401(c);

(4) Receipts from any other source which may, from time to time, be credited to the Fund.

(c) If, after any amounts which may have been advanced from appropriations have been credited to the appropriations from which advanced, the Board determines that the moneys of the Fund are in excess of current needs, it may request the investment by the Secretary of the Treasury of such amounts as it deems advisable in obligations issued or guaranteed by the United States.

#### APPROPRIATIONS

Sec. 502. There are authorized to be appropriated such sums as may be necessary to carry out the provisions of this Act. In the event there are insufficient moneys in the Fund to meet obligations of the Board, the Secretary of the Treasury shall transfer to the Fund such sums as may be necessary to fulfill such obligations. The Secretary of the Treasury may use, for the purpose of making any such transfer, the proceeds from the sale of any securities issued under the Second Liberty Bond Act; and the purposes for which securities may be issued under such act are extended to include the purchase of any such notes or other obligations.

[S. 2523, 94th Cong., 1st sess.]

A BILL To amend the Emergency Loan Guarantee Act to permit the Emergency Loan Guarantee Board to guarantee the bonds of States and municipalities

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That (a) section 4(a)(2) of the Emergency Loan Guarantee Act (Public Law 92-70) is amended by inserting "(A)" immediately after "(2)", by striking out the period at the end thereof and inserting in lieu thereof "; or", and by adding at the end thereof the following new subparagraph:

"(B) or in the case where the borrower is a State or political subdivision thereof, such State certifies that it could not lend the political subdivision sufficient funds or guarantee that political subdivision debt instruments in order for that political subdivision to meet its needs without jeopardizing the financial stability of the States."

(b) Section 4(b) of the Emergency Loan Guarantee Act is amended by—

(1) striking out "Loans" and inserting in lieu thereof the following: "In the case where the borrower is not a State or political subdivision thereof, loans"; and

(2) inserting at the end thereof the following new sentence: "In the case where the borrower is a State or political subdivision thereof, shall be payable in whatever period of time the Board shall, by rule, determine to be appropriate."

SEC. 2. Section 5 of the Emergency Loan Guarantee Act is amended by inserting ", except in the case where the borrower is a State or political subdivision thereof," immediately after "shall" the first time it appears therein.

SEC. 3. Section 6 of the Emergency Loan Guarantee Act is amended by inserting "or State or political subdivision thereof" immediately after "enterprise" each time it appears therein.

SEC. 4. Section 6 of the Emergency Loan Guarantee Act is amended by inserting after the end of section (f)—

"(g) The Board, in granting a loan guarantee to a debt issue of a State or its political subdivision—

"(1) shall require that the debt instruments be subject to Federal taxation;

"(2) shall require that the State or agency granted a loan guarantee give evidence that its budget will be balanced by real revenues within three years after the guarantee is granted and for the period of time covered by the guarantee;

"(3) shall require that only full faith and credit obligations shall be eligible for the guarantee;

"(4) may require that a member of the Board or its designee serve on the State or local governmental agency or agencies which have the responsibility for revenue collection and expenditures;

"(5) may require that the State or local agency adopt fiscal guidelines and rules and regulations deemed necessary to assure payment of interest and principal on the debt instrument guaranteed by the Board."

SEC. 5. Section 7 of the Emergency Loan Guarantee Act is amended by inserting "or State or political subdivision thereof" immediately after "enterprise" each time it appears therein.

SEC. 6. Section 8 of the Emergency Loan Guarantee Act is amended by striking out "\$250,000,000" and inserting in lieu thereof "\$50,000,000,000".

SEC. 7. Section 12 of the Emergency Loan Guarantee Act is amended by striking out "June 30, 1973," and inserting in lieu thereof "June 30, 1977,".

SEC. 8. Section 13 of the Emergency Loan Guarantee Act is amended by striking out "December 31, 1973," and inserting in lieu thereof "December 31, 1977,".

SEC. 9. The Emergency Loan Guarantee Act is amended by adding at the end thereof the following new section:

#### "DEFINITIONS

"SEC. 14. For purposes of this Act, the term—

"(1) 'State' refers to any State of the United States or the District of Columbia.

"(2) 'political subdivision' means a city, town, borough, county, parish, or district created by or pursuant to the law of any State."

### STATEMENT OF SENATOR TOWER

Senator TOWER. I have a brief statement, Mr. Chairman. Noting our reason for meeting today is not a pleasant one, the Nation's largest city has been brought to the brink of financial default. The second most populous State is in severe financial straits. Other solutions having failed, Federal intervention is being sought. We are here to listen to the problems and proposals for their resolution. We have to cut aside the rhetoric, emotion, claims, and counterclaims to consider a variety of factors.

This situation cannot and must not be ignored. Having examined the causes, we must pierce the borders of cities and States to assess

the national impact. We must examine the proposals for relief that have been offered. With the record established, we can determine whether involvement of the Federal Government in this instance will share the burden or encourage the spread of this situation beyond current problems.

Senator BROOKE. Mr. Chairman, I have a statement. In the interest of time, I will not read it but I ask it follow the statement you made and the statement of Senator Tower.

[The statement follows:]

#### STATEMENT OF SENATOR BROOKE

Senator BROOKE. For the past 6 months, we have all watched the financial unraveling of the city of New York with growing apprehension. The sheer size of New York City's debt makes its insolvency a matter of national concern. And I suppose it was inevitable that faced with the financial collapse of New York City, the Congress would be called upon to decide whether Federal assistance should be provided.

New York is our largest and most important city, the financial capital of the country. It is a major commercial center, and provides a forum for world political discussion. Moreover, the residents of New York make significant contributions to our culture. No American who understands the important role New York plays in our national economy and culture can fail to wish the city well.

However, Mr. Chairman, I must state that I have grave reservations about the wisdom of financing the debt of the city of New York through Federal loans, guarantees, or insurance. For 200 years, our Federal system has left to State and local governments the responsibility for financing their own activities. This tradition has worked well for us, and if we depart from it here, I do not know when, if ever, we shall return.

The first major public position I held in Massachusetts was the chairmanship of the finance commission for the city of Boston, and in that job, I learned something about municipal finance. I don't think there can be much doubt that the city of New York has not been responsible in the management of its finances. But I also do not believe that the issue before this committee is whether or not New York City "deserves" assistance. Rather the question is this: If the city of New York defaults, how much damage would that do to our national economy?

Our Founding Fathers established a Federal system of Government for many good and practical reasons. For my part, Mr. Chairman, I would be loath to support any bill which would ensnare the Federal Government in the local budget making process except in the face of a grave threat to the national welfare. However, I shall listen carefully to the testimony at our hearings, and I shall keep an open mind on the question of whether we should provide Federal assistance to New York City.

The CHAIRMAN. Senator Jackson, do you have a statement?

Senator JACKSON. Yes.

**STATEMENT OF HENRY M. JACKSON, U.S. SENATOR FROM THE  
STATE OF WASHINGTON**

The CHAIRMAN. Because there is a parallel jurisdiction with their committee, Senators Ribicoff, Percy, and Javits will join us in part if they wish to do so at the hearings.

Senator JACKSON. I welcome this opportunity to ask that you give serious consideration to Senate bill 2372, a measure designed to save the Nation's cities from collapse in our present economic turmoil. I am pleased that Senators Humphrey, Ribicoff, Magnuson, Williams, and Javits are cosponsoring this legislation.

This legislation will provide Federal guarantees for municipal bonds, in much the same way that the Federal Deposit Insurance Corporation provides guarantees for bank deposits.

New York and the other cities of America are not asking for bail-outs. They are asking for help in helping themselves.

This bill will benefit New York, and every other city, town, and county in America; and any subdivisions of a State which qualify, such as school districts, water districts, and similar entries.

It was not designed to save New York, but New York must be saved.

To show callous indifference to the fate of the Nation's largest city—its greatest city—as the administration is doing, is beyond comprehension.

If New York City goes under, no city in the Nation is safe. If New York City goes under the State of New York may well go under—and no State in the Nation will be safe.

This is truly a national problem, and it demands a national solution. Inflation and recession grip the national economy, and cannot be combated on a local level.

I find the indifference of the administration to this national crisis shocking and irresponsible. At a time when our economy is already fragile, this kind of indifference is especially indefensible.

Secretary Simon says it is something we shouldn't bother with.

It is beyond my comprehension in light of Dr. Burns' statement of yesterday.

If it is based on ideology the administration should not allow itself to be blinded to reality by rigid, outmoded ideologies.

If it is based on politics, let us realize that the situation is too serious to allow for playing politics.

Unless the National Government acts, we face a serious disruption of the municipal bond market.

We face a crisis of liquidity for many commercial banks.

We face a threat to the security of thousands—millions—of investors throughout the country.

Today, there is over \$207 billion in tax-exempt bonds outstanding. Interest rates on municipal bond issues have jumped upwards recently—and not only for New York but for every government unit in the country.

I think that is a significant point, which demonstrates it is a national problem, and not just a New York problem.

The Bond Buyer Index tells the story. In January 1974, the Index stood at just over 5 percent. Today, 18 months later, where does it stand? It has gone up over 50 percent in these 18 months, and now

stands at an all-time high, 7.67 percent. And every week, it continues to jump upward to reach new record levels.

With \$207 billion in municipal bonds outstanding, these incredible increases in interest rates are costing millions of dollars now, and will eventually cost billions. Instead of paying for policemen, firemen, teachers, sanitation men, scarce tax dollars will be siphoned off into paying high interest rates.

And if New York City and New York State go into default, let us be clear on the impact. For of that \$207 billion national municipal bond market, nearly \$35 billion represents bonds of New York State and New York City.

There is hardly a major bank or insurance company in this country whose portfolio does not contain millions of dollars in New York State and City bonds. The banks of New York State are estimated to hold perhaps \$5 billion in these bonds. The financial institutions of America are, taken together, estimated to hold a total of perhaps \$17 billion in New York bonds.

The effects of a default by New York City and New York State on our financial markets are therefore clear.

I can only hope that Congress will take matters into its own hands and pass this and similar legislation to head off a municipal bond panic throughout the country.

Senate bill 2372, the Fair Financing for Local Government Act of 1975, assures the availability of credit on reasonable terms to counties towns and cities whose finances are in order.

The Federal Government would stand behind the obligations of local governments, protecting investors and encouraging them to invest in their communities.

The act would further encourage the development of new sources of private investment capital for local obligation bonds.

The Federal Government would provide reinsurance of 75 percent of private insurance coverage an issuer could obtain.

Further, the act would provide that when a State assists local governments in securing credit, the Federal Government would guarantee 75 percent of any State obligations.

To qualify for Federal guarantees, the State agency must itself be in sound financial shape, and must insist on rational budget practices and accurate accounting procedures by local governments.

Mr. Chairman, I ask that a factsheet describing S. 2372 be included in the record following my remarks.

The CHAIRMAN. Without objection that will be so done.

[The document follows:]

#### FAIR FINANCING FOR LOCAL GOVERNMENT ACT OF 1975

1. The three key goals are:

- (a) To lower interest rates paid by local governments on their bonds.
- (b) To enhance the marketability of local government bonds.
- (c) To promote sound local government finance without direct federal intervention in local government financial affairs.

2. The Basic Plan:

A. A Fair Finance Insurance Board would be established by the federal government. The Board would charge premiums for its services and, like the Federal Deposit Insurance Corporation, is designated to be self-financing.

B. Re-Insurance—Insurance policies are available for some municipal bond issues. The Board would be empowered to reinsure 75% of municipal bond insurance issued to a city by a private insurance company.

C. Guarantees—The Board would also be empowered to guarantee 75% of the bonds issued by any state agency set up to help local governments. (Such agencies already exist in Vermont, Maine, and New York, and some local government bonds are state-guaranteed in California, New Hampshire, Michigan, and Minnesota.)

Sound economic standards for localities would be assured in three ways:

(1) Since 25% of the value of the bonds is not insured, the state would have an incentive to monitor city finances and avoid losses should a city default;

(2) The Board is required by the Act, before issuing a guarantee, to determine that the state agency prescribes and enforces strict accounting standards, financial controls, and balanced budget programs;

(3) Any state agency which failed to comply would be disqualified from the guarantee program.

### 3. The Fair Finance Insurance Board.

The Board would consist of a Chairman and four members, all appointed by the President with the advice and consent of the Senate.

The Board Chairman and members would be individuals from academia, the labor movement, commerce, or government, who are by their experience well qualified to carry out the purposes of this Act. They shall serve terms of five years.

In addition, the Secretary of the Treasury and the Secretary of Housing and Urban Development will be ex-officio members of the Board.

### 4. Local Securities Market Study.

The Board will conduct a study of the national market in local government securities, focusing especially on:

(a) The availability, and present and potential sources of funds for the purchase of such securities;

(b) Influences on, and developments in, interest rates for such securities;

(c) Suggested reforms in the financial structures and functioning, and in present methods of financing the activities of local governments;

(d) Federal and state efforts to assist in the marketing of such securities.

### 5. Local Government Advisory Committees.

The Board will establish special advisory committees to consult with it and provide it with advice and needed information. These advisory committees will consist of representatives of:

(a) City, county, and state governments;

(b) The labor movement;

(c) The financial community.

Senator JACKSON. I do not claim to have all the answers to this immensely complex problems. But I believe the Fair Financing Act is a start.

It allows for the needed Federal role—without undue Federal interference with local government affairs.

It helps local governments which are trying to help themselves.

It allows for a State role—and for a contribution from private enterprise.

It is a major new step, but it is not so earthshaking a departure that it is impractical. All it requires is recognition that the finances of cities and towns and counties are a national concern—and the will to act when those finances are threatened.

The Fair Financing for Local Government Act is a practical plan to come to the assistance of local governments being badly hurt—by the national recession, and national inflation. It calls for national action.

I urge that the Committee give this bill favorable consideration.

Thank you, Mr. Chairman.

I hope we act without delay because I believe, Mr. Chairman, that the situation is so precarious that if a default occurs before we act, an effort to try to pick up the pieces legislatively will be costly. And

it will not be as effective as will a remedy now, through the legislative mill, to deal with that problem.

The CHAIRMAN. Thank you very, very much, Senator Jackson. We appreciate your presentation.

It is a little puzzling to the Committee to know how to proceed. Both of your colleagues are on the floor and I know you are interested in that, too.

Senator JACKSON. I'm cochairing a conference where we have 40 participants on energy.

The CHAIRMAN. The principal provision of your proposal is that the Federal Government would provide insurance of 75 percent of the value of the obligations of the city or town or State that was involved, is that correct, sir?

Senator JACKSON. That is correct, sir.

The CHAIRMAN. The other 25 percent could be provided in the case of New York City, for example, by New York State or by private group of businessmen or banks or any other group?

Senator JACKSON. That is right. As the Chair knows, some firms have started into the insurance business as it pertains to municipal bonds on both ends. They will provide insurance for the investor and also insurance to municipalities or subdivisions of a State. I think one such company, and I believe the first to pioneer it, is MGIC with headquarters in Milwaukee. They were the first to go into this particular market area. On a limited scale obviously. But their coverage contemplates dealing with both situations.

The CHAIRMAN. Now, you do not require that the instrument insured be taxable. New York has indicated they are willing to pay the premium price or the penalty of issuing a taxable security that would be guaranteed. There has been objection on the part of many people to guaranteeing a nontaxable security because it would make it superior to any other kind of issue.

To have 75 percent faith and credit of the U.S. Government, it may be viewed by most as equivalent to a full coverage from a practical standpoint and it would not be taxable. There has been strong resistance in principle by the Treasury on that.

Senator JACKSON. The Chair raises a proper question. I would make a couple of observations. This is of the essence. Time is running out. There is a joint jurisdictional problem with the Finance Committee that would have to be worked out.

I would point out two things. One is that the guarantee is 75 percent and not 100 percent, so that if it is the judgment of the committee that these bonds should be subject to tax it may be something less than the total tax. That is a consideration in view of the fact that the guarantee of an issue is 75 percent and not 100 percent. As the Chair knows most of the Government guaranteed bonds, such as those of the Farmers Home Administration, Federal Land Bank, and similar institutions, issues guaranteed by the Government, are exempt from State and local financial taxes or other taxes under existing decisions of the court. I assume that that would be kept in mind in connection with this particular problem.

Mr. TOWER. Mr. Chairman, I have no particular questions. I feel, however, that I would be remiss if I didn't make a comment. I feel I would have to take issue with my friend from the State of Washing-

ton, who has been my ally in many battles not relating to New York City.

“. . . the situation is too serious to allow for playing politics,” et cetera—This has been hung on the administration by my distinguished colleague. If that tag applies to the administration, it applies to a number of people in this country, both Democrat and Republican, who raise rational and, I think, legitimate and pragmatic concerns. There is widespread feeling all over the country that New York City has lived beyond its means, played politics too often in passing out the “goodies” as Fortune magazine has said, and has not managed its affairs in the responsible way that the vast majority of cities in this country have.

There are a lot of serious questions that the American taxpayer raises in relation to this that have to be answered. It doesn't stem from callous indifference on his part or shocking irresponsible attitude. I don't think it has much to do with ideology or politics. The vast majority of people in my State, bankers in particular, are opposed to doing anything about New York City. They are lukewarm if they do favor it.

There is legitimate concern all over the country that we may set dangerous precedents here that would result in the same sort of thing occurring in other cities. It is a concern that we will create problems in other cities, rather than solving the problems for the one city.

Senator JACKSON. I think it was callous for the Secretary of the Treasury and the White House, in general, to have said that is a New York problem and it will not impact elsewhere. That is a failure to understand the way in which a bond market will react.

May I say, one of the first letters that I received in support of this legislation came from Governor Herschler, of Wyoming. They continue to sell their bonds. What concerned me is that the administration failed to comprehend the all-pervasive impact of what happened in New York.

The fact is that your leading banks would be insolvent if New York defaulted, and there is a failure to recognize, I think, the rim effect of this kind of activity.

Saying that it is a New York City problem—I insist on a tough financial standard—but to say it is just a New York City problem begs the question. If New York defaults and Burns now has made a completed switch in his position, and he recognizes—if New York defaults it will be chaos.

Helmut Schmidt, who is a responsible Chancellor of Germany, came in and pointed out that the collapse of the New York bonds would have an international impact. There is something in economics that always gets us in trouble when we try to project. That is the element of confidence and psychology. No one can read the numbers and try to determine the psychological impact on a given situation. It is in that context that I made my statement. I stand by it.

I think there is a callous indifference. The administration is now coming around to recognizing that it will impact beyond the State of New York, and it already has.

Senator TOWER. I was simply saying that the perception of New York as having been irresponsible is pretty widely held over the country. We need to be concerned that we don't encourage other cities to engage in spending beyond what its tax base or Federal or State aid will support. If we do we will create much larger problems.

Senator **PACKWOOD**. I'm intrigued with some of Senator Jackson's figures; \$207 billion in municipal bonds outstanding in this country, \$35 billion of which are New York State or New York City bonds. What that means is that New York State with 8½ or 9 percent of the population of this country—they have 18 percent of the outstanding debt interests in this country. It seems to give credence to the claim that they have been paying their way more on a debt basis than pay-as-you-go basis if those figures are true.

Senator **JACKSON**. I don't know whether you can come to that conclusion. I'm not here to discuss what has happened in the past in New York City. The bill I'm proposing would require real tough standards for meeting the eligibility requirement to get insurance. New York City and State are engaged in a lot of activities. They have a power authority that issues municipal bonds. They have been involved, as the Senator knows, in large housing projects. One of the biggest ones is the one that then Governor Rockefeller sponsored in the housing field, that had been turned down by the people in the State in a referendum, and which he pounded through the legislature. It has since defaulted.

That issue is over a half-billion, and went into default.

Senator **PACKWOOD**. I'm only saying that for some reason they used debt financing disproportionately more than their population bears to the rest of the population in this country.

Senator **JACKSON**. That may be. May I point out to the Senator that for one reason or another the top banks in the Nation, and the second largest is there, and the third largest, First National City and Chase Manhattan—they are heavily into those bonds. I assume bankers in New York City are prudent, especially Chase Manhattan. I would think that they must have recognized those bonds were good.

It is not just New York City that has this problem. There is a serious situation in Newark, Cleveland, Buffalo, and other places.

This legislation does not assist and help those who are not prudent.

All I'm saying is that you can't isolate New York City and New York State from the rest of the Nation. That is the line the administration was taking until yesterday when Dr. Burns came down very strong on quick, decisive action lest it create a panic.

Senator **PACKWOOD**. What does your bill provide in terms of Federal Government guarantees? Once we guarantee a bond and there is a default, how do we get our money back?

Senator **JACKSON**. We set up an insurance arrangement. There is a 1 percent fee you have to pay. If it is a 6-percent bond they have to pay 1 percent. That goes into the corporation and that is the means of financing.

Senator **PACKWOOD**. You mean every municipality has to pay that additional 1 percent?

Senator **JACKSON**. Those who want to participate. Yes, it is insurance. You don't insure something without paying a premium.

Senator **PACKWOOD**. In other words, every city that has a good credit rating if they want to participate, their bond will go up 1 percent in order to participate.

Senator **JACKSON**. The point I would make in response to that, and it is an obvious one, the obvious point is with government insurance their rating would go up and interest rate would go down. The Bond

Index has gone in a little over a year from 5 to 7.67 percent. What this insurance program would do is bring that interest rate down, and the 1 percent they pay would be more than compensated because the rates would drop more than 1 percent.

So that they would have a lower service charge, and when you have \$207 billion in bonds and when the bond interest rate goes up 1 percent, obviously the increase in cost is over \$2 billion a year. For those municipalities or municipal subdivisions of a State. That is what we seek to do.

Senator TOWER. Would the Senator suspend? There is a vote on the Senate floor. I understand there will be two back-to-back votes.

Under the circumstances we will recess the hearing.

Would you be able to come back, Senator?

Senator JACKSON. Yes, I will come back.

I thank the Chair.

(Recess.)

The CHAIRMAN. Senator Jackson, we are glad to have you back. We apologize for the interruption.

Senator GARN?

Senator GARN. Thank you, Mr. Chairman.

Senator Jackson, I don't want you to interpret my remarks as anyway directed at you or your bill. I feel strongly about this issue, as you well know. Nine months ago I was mayor of a city and president-elect of the National League of Cities. Among the majority of mayors in this country, you would find overwhelming opposition of bailing out New York City or anyone, primarily because those of us who ran our cities in an efficient way and balanced our budgets—well, New York gave us trouble for years.

We were told by our employees, this is what they pay in New York, and we ought to be paid the same. Regardless of what we ultimately decide to do with or for them, we ought to recognize what the causes are. And, in my opinion, and in the opinion of a lot of other mayors around this country, it is gutless, irresponsible leadership. We have politicians in New York City who have yielded willy-nilly to every demand by the unions, sanitation workers—\$18,000 a year for a sanitation worker, et cetera.

My salary as a full-time administrator of an entire city was \$19,400. I was once talking to four or five New York State senators. I told them this as bluntly as I have stated it here. I was surprised when they all agreed with me since they were all representing New York City. One of them said it is worse. He said sanitation workers put in 4½ hours a day. You have seen how dirty New York is, they don't do a good job at it anyway. That man said that the sanitation workers union is one of the strongest in the city. "If I said to them what I just said to you, we wouldn't be returned to Albany."

They have yielded to the pressures. I find it difficult to think the residents of Utah or Oregon or anywhere else should put their backing behind a city that is financially irresponsible. There is packing of that city payroll, they have more employees per capita, and the services are lousy, despite those expenditures.

This is not directly related to this bill. I think it needs to be said, and the public ought to know why New York is in the state they are in. Maybe if the Governor of New York would put a sufficient tax on

the residents of New York State to bail them out, and the residents said we don't want to do it anymore, then we would get more responsible leadership in that area, and the people would realize that they have been getting ripped off.

That is a callous statement, but as a former mayor, I have little sympathy for the kind of irresponsible leadership that has been exhibited in New York by the mayor and councilmen for a long, long time.

Senator JACKSON. I appreciate the Senator's statement. I am not prepared to go into the problems of the city of New York. We are confronted with a condition, not a theory. What do we do if New York defaults? There is an overwhelming majority view that the impact of such a default could be catastrophic in terms of the financial community. It is a situation which is pervasive and impacts everywhere. I have some letters here. I have a letter from the mayor of Tucson strongly supporting the legislation, because of the problems they are running into. They are a financially sound community. I am talking about interest rates and the ability to sell bonds.

The Governor of Wyoming strongly supports the legislation, because they are running into trouble. They are running into trouble in my State in being able to even sell bonds. We have to ask ourselves what do we do in this kind of situation?

What I am suggesting here under this proposal is that you set up an insurance program which should not cost the Federal Government any money. They would pay a 1-percent premium into a fund like the FDIC. It should be self-liquidating. It would have the effect of at least dealing with a problem that has seriously affected areas other than New York City. In fact, the municipal subdivisions of every area of the country have been hit. The value of a bond has gone down. The interest rates have gone up. It is continuing and will cost literally hundreds of millions of dollars more in the immediate period to service the debt on these issues. The city of New York is a separate problem.

In order to qualify for insurance on future bonds, they would have to make very stringent—meet very stringent criteria as set out in the bill on page 10. I wanted to emphasize that. This is not a bailout. This is a sound insurance program, where when a community does have a proper rating, a Moody rating, they can be eligible, and it will in effect reduce the costs of servicing that debt. And, second, it will stabilize the market, so they can sell the bonds.

The city of New York's problems, the city of Newark's problems, the city of Cleveland's, are all separate issues. What I am trying to deal with is the impact that these developments are now having on the situation. Now, we have got the assurance, I believe—the Chair would know, because he is on the Joint Economic Committee—when Dr. Burns testified they have a contingency plan to save the banks in New York by, in effect, guaranteeing the paper or seeing to it that the paper they hold will be honored. They will bail out, in effect, the leading banks in New York, in the event of a default. The percentage of bonds they hold should there be a default—percentage of New York bonds they hold—should there be a default, would render some of these banks or virtually all of them, insolvent.

The impact of insolvency in the major banks in New York would reverberate all over the United States and in the international market

as well. Chancellor Helmut Schmidt recently made that comment. Germany has probably one of the stronger economies of Europe. When he makes that observation, I think it has to be taken seriously.

Senator GARN. With all due respect, I would not agree with you as to the dire consequences that may happen as a result of default. I have a real fear on the other side of the coin.

Senator JACKSON. What do you do with the banks?

Senator GARN. I am not convinced that the banks would fold because of this.

Senator JACKSON. Dr. Burns said unless the Fed is prepared to step in, they will be insolvent. I don't think it could be any stronger. You are talking about the second and third largest banks in America. The second largest is First National City and third largest is Chase Manhattan.

Senator GARN. I don't always agree with Arthur Burns.

Senator JACKSON. I don't always, but he has now made a 180° turn.

Senator GARN. We hear about the dire consequences that will happen, if we do not help in New York. I think there are dire consequences on the other side. There are a lot of other mayors around the country who would like to be reelected. I think you can see a trend of a city saying, "I can go ahead and promise the big pension benefits and free this and that and if I get in trouble, the precedent has been set, because they bailed out New York and they will now bail out me." I think there are consequences in that direction.

Senator JACKSON. This bill is not a bailout.

Senator GARN. I understand that. I am diverting from your bill to make some of these other comments.

The CHAIRMAN. I understand Senator Packwood has not finished. The Secretary of the Treasury has agreed to come down, but he has an urgent appointment later.

Senator Packwood. It seems, Senator Jackson, New York can be bailed out for one of three reasons. They are more deserving of any other city. Two, the banks will fail and we can't allow the banks to fail. Three, other cities won't be able to sell municipal bonds if New York defaults. I am not sure the last case has been made yet. I was intrigued with the New York Times story yesterday about the American Bankers Association Convention in New York. A survey of bankers' attitudes was conducted by the New York Times. Questionnaires were handed out to 2,000 bankers. The respondents represented a wide cross-section of the banking community, both geographically and in size of institutions. The results were that, despite Mayor Beame's pleas to the banking convention, by margin of more than 2 to 1, the bankers felt that the Federal Government should not assume a role in the New York financial crisis. If the banks are worried as you suggest—this poll does not indicate that. This poll indicates that the overwhelming bulk of the bankers in this country are not really seriously worried about New York City defaulting on its bonds.

I have no other questions, Mr. Chairman.

Senator JACKSON. May I observe that, of course, the bulk of the bonds are held by the New York banks. You might ask the Secretary of the Treasury what would happen to the banks in New York if New York defaults.

May I mention that my understanding is, and I may be wrong, but the Chair, I am sure, will be pursuing this, that Mr. Wriston, who is head of First National City, and Mr. Rockefeller, who is the head of Chase Manhattan, have come out for help. Their banks are pretty well loaded with these bonds.

Senator PACKWOOD. That is the reason they called for help probably. They have a heavy portfolio of these bonds.

Senator JACKSON. Would you allow the banks to go into insolvency?

Senator PACKWOOD. I am not sure nor am I sure of the merits of your bill to require all municipalities to pay another percent.

Senator JACKSON. Not require.

Senator PACKWOOD. They won't be able to sell their bonds unless they join.

Senator JACKSON. It is voluntary.

Senator PACKWOOD. But from a practical standpoint you can't sell your bonds unless you join.

Senator JACKSON. It is practical. It says those municipalities that can qualify, should not be penalized in interest rates by what happens elsewhere. That is the thrust of it. The most important thing in economics, where the forecasters all go off the deep end—Einstein started out life being an economist and after 18 months he quit, because he found it too imprecise, too indefinite and too uncertain, and turned to the study of mathematics or physics. The forecasters go off in human behavior, the so-called element of confidence or lack of it, the psychological impact. Those are not measurable things, because human beings are not measurable.

Why should we penalize cities that are solvent, cities that are in a position to demonstrate that they have a good fiscal policy? Why should we penalize them?

Senator PACKWOOD. You say they are being penalized, because of New York City's potential default and that is the reason interest rates are going up. I don't think that case has been proven yet.

Senator JACKSON. Mr. Chairman, I suggest you bring in people. We have been in touch—I tried to study these things carefully—we have been in touch with people in the financial community here, experts on municipal bonds and the bond market. I would prefer not to testify on that. Call for the best evidence. The best evidence is the people that are qualified in that area. The overwhelming information that has been coming into us is that that case has been made. The bond market is in a state of disarray. May I suggest that one man in the private sector who happens to be in the second oldest firm, Henry Kaufman, is probably one of the ablest economists in the country, with Solomon Brothers. If you want to look for a scholar, if you want to look for an outstanding businessman and investment banker, you might ask him to testify. I think you would get a good deal of what all this means.

I am not saying bring in a wild character from Podunk, from some college, who may have a different view, but I am talking about one of the oldest and biggest bond houses in the country.

Senator PACKWOOD. Is that the same Kaufman who said a year ago that if we have \$70 billion in debt interest rates would rise?

Senator JACKSON. I don't know about that, but I would say Mr. Kaufman is one of the outstanding economists in the country. In the area of interest rates his track record is good. If you have an economist

who has a perfect record, I would like to meet that one. I have never met one who has had a perfect track record.

Senator RIBICOFF. Mr. Chairman, first my appreciation to you for allowing me to participate in these hearings. Senator Jackson, the comments made by our colleagues, Senator Garn and Senator Packwood, have to be taken very seriously, because they do reflect a large segment of thinking in the United States. The points they make will be the subject of continuous argument in committee and on the floor. I think a couple of points should be made to take into account their comments. First, your bill is not a New York City bill. It is national in scope.

Senator JACKSON. That is correct.

Senator RIBICOFF. A recent Congressional Research Service report shows out of 140 local governments surveyed, 122 entered the current fiscal year with a combined surplus of \$340 million. They will end the year with a \$40 million deficit. This indicates that you have a national trend that involves more than New York City. Isn't that correct?

Senator JACKSON. The Senator is correct. There are several cities that are really on the brink, that are in deep, deep trouble.

Senator RIBICOFF. At the beginning of the week, under the chairmanship of Senator Humphrey before the Joint Economic Committee, 14 of the mayors of the largest cities of America even cities in good financial condition testified that there was a great ripple effect throughout the Nation, affecting their ability to finance and raise money for bonds, and when they did their interest rates were up between 100 and 200 percent, because of the New York situation.

Senator JACKSON. The Senator is correct. When it goes up just one point with a \$207 billion outstanding municipal portfolio, it goes up \$2 billion, just 1 percent with that kind of portfolio.

Senator RIBICOFF. Mayor Landrieu was on the Today Show this morning and made a pertinent comment. He said New York City had become the national service center of America, that the problems of the entire Nation were dumped into New York. It is losing middle class population and jobs and getting the poor, black, and the old coming into New York City. As a consequence, the problems of the Nation are being dumped onto the backs of New York City.

In 1971 before the Finance Committee I proposed that we nationalize welfare. If in 1971 we had nationalized welfare, New York City and New York State would have had a billion dollars more in revenue. The revenue received, a billion dollars a year, would have helped prevent New York City from reaching the deficit state it is now in. We have a problem. We have been studying this so long. Welfare is national in scope. The blacks and poor keep coming in from the South over the last two decades into New York City. The white middle class come into Connecticut and we are glad to have them, or New Jersey. That city goes down as we drop the poor into New York.

Senator JACKSON. I have made speech after speech supporting your position. It makes no sense to require the States—ever since the Supreme Court rule that there can be no residence requirement in connection with eligibility for welfare—to place the burden of that task, which is a national responsibility, on the States and the cities. In my State, the State of Washington bears its 50 percent, but in New York the city of New York bears—

Senator RIBICOFF. Twenty-five percent.

Senator JACKSON [continuing]. Twenty-five or 30 percent of the share that is borne by the State. It is into New York City where you have had the greatest influx.

Senator RIBICOFF. It is even more than that, Senator Jackson. We, in the Congress of the United States, have jiggered all Federal contributions in such a way as to help the rural areas at the expense of the city.

The welfare payments go from the Federal Government, anywhere from 50 percent to the States like New York and Connecticut to 83 percent to the rural cities in the United States. Then they dump their rural poor into New York City. The revenue-sharing formulas in this country unfortunately do not take into account sufficiently the urban factor and welfare.

If the administration is sincere, there is much they can do to come to the Congress and try to have a sense of equity throughout the United States on all our revenue-sharing formulas, because the revenue-sharing formulas are so structured to make sure that cities like New York remain poor.

Senator JACKSON. I agree with the Senator. I support his position. Welfare is a national problem and requires a national solution. When you have these pockets like New York City, where you have inordinate influx of people who, in turn, represent an inordinate percentage of those who go on welfare, you are inviting bankruptcy, and I know of no other area in the United States where there has been such a heavy influx of people coming in, who will become eligible for welfare.

The CHAIRMAN. Thank you very much, Senator Jackson. You have been most helpful.

If the committee would permit, I'd like to suggest that we do something a little different. Secretary Simon is here. Senator Humphrey is here. We have asked Secretary Simon if he would permit Senator Humphrey to speak for 7 or 8 minutes and give his presentation and then ask the committee if they would agree to simply let Senator Humphrey go. That's asking an awful lot, knowing Senator Humphrey, but will you come forward right now and deliver your statement without our having a chance to question you?

#### STATEMENT OF HUBERT H. HUMPHREY, U.S. SENATOR FROM MINNESOTA

Senator HUMPHREY. Mr. Chairman, you're going to miss a great opportunity.

The CHAIRMAN. I'm sure we are.

Senator HUMPHREY. I think you're denying yourself the best part of the day.

The CHAIRMAN. I'm sure we are. Go ahead.

Senator HUMPHREY. Mr. Chairman and members of the committee, as Senator Jackson and others have said here earlier the Joint Economic Committee had hearings on this subject. I believe that the chairman was very active in those hearings as was Senator Ribicoff and others. I am presenting to the Senate today a bill which would establish an Emergency Intergovernmental Assistance Board to extend aid to hard-pressed municipalities and local governments.

I also present for the use of the committee a short description of the bill.

The CHAIRMAN. And the statement will be printed in full in the record.

Senator HUMPHREY. If one examines the issue before this committee carefully, it's clear that the question before your committee is not, "Should the Federal Government provide assistance to New York?" but rather, "Should the Federal Government provide assistance before or after default?" That's the issue. Let me explain to the committee what I mean by this statement.

If the Federal Government does not assist New York City by mid-December the city will most certainly default on its obligations before the end of the year. We have had no testimony to the contrary. However, the act of default will not eliminate the need for the city to borrow money. The city will have to borrow approximately \$1 billion in January, February and March in anticipation of real revenues that will be received later in the fiscal year.

Now the city will have to borrow that money or close down. So the question is: What does default do to the capacity of the city to borrow the billion dollars that it has to have just as surely as human beings have to have water and air in order to live. The city will also have to borrow to help cover the deficit this year, a borrowing which even those who are calling for large cuts in the operating budget of the city realize is necessary. If the city cannot obtain these funds, which is certainly probable if the city were in default, it would simply be unable to meet payrolls, to issue assistance checks, to provide the public services that a people in a large metropolis need.

Clearly, the result would be disastrous. We are not just talking about an ordinary financial operation. We are talking about literally the life and the death of a city—its ability to provide for its people.

At this point the Federal Government would have no choice but to intercede. I believe this committee has to consider the possibility of open chaos in the city of New York with all the adverse consequences that implies. The city must have a billion dollars in borrowing before the anticipated revenues from taxes can be collected.

It is this fact of life which causes me to conclude that there's no constructive purpose to be served by default. Federal assistance will be necessary even subsequent to default. In fact, the need for Federal assistance may even be greater if the effects of default are as serious as some here have projected, and the Chairman of the Federal Reserve Board has made it very clear that if the city defaults the Fed has emergency plans to save the banks. I only wish that the Chairman of the Federal Reserve Board were chairman of the city because he takes care of his clients. His constituents, he has testified in this very room as of yesterday, will be protected by unlimited funds for the banks.

So what you're really considering is do we take preventive action before default or do we let default or bankruptcy run its course. Then ask yourselves the question: Who will loan the city a billion dollars to operate from December until April?

Consider those cold months in New York City; consider no police, no firemen, consider no sanitary services; because the billion dollars is absolutely essential to the city. It must borrow and then can collect the taxes that would repay the billion dollars.

Now after default or bankruptcy you have to ask yourselves what rate of interest would they have to pay on the billion dollars or could they even get it at all? That's New York.

The subject of today's hearing is undoubtedly one, however, whose significance extends far beyond the boundaries of New York City and New York State. This is no bailout of New York City or New York State any more than saving the Franklin National Bank was a bailout of that bank. That was to save the banking structure of this country. That's what that was all about. That was its justification. The Federal Reserve Board did not save Franklin National Bank because they loved the officers of Franklin National, who had mismanaged Franklin National. The Secretary of the Treasury will tell you, as has the Chairman of the Federal Reserve Board under testimony before the Joint Economic Committee, that the Federal Reserve Board stepped in to save Franklin National for fear that if they didn't, it would tear apart the entire banking system. He's testified to that. It's a matter of public record.

To be sure, the 8 million Americans that reside within the boundaries of this city will be most seriously affected. But even without default they face significant cutbacks in services, freezes on employee wages, work force reductions, and other severe hardships. In fact, most of those steps have already been taken. Only yesterday, Senator Proxmire, you outlined in the Joint Economic Committee the steps that had been taken by the city of New York and the State of New York. I will not burden the record with going through those again, but they were many.

The issue becomes all the more serious when it is recognized that the State of New York is now involved in the finances of the city. It is likely that the mere existence of the default will greatly jeopardize New York State's own ability to obtain financing in the capital markets. That's been testified to by the Chairman of the Federal Reserve Board and others. We must all understand that the State will have to borrow up to \$4 billion for its own purposes and functions by June 1976, a feat which would be improbable should the city default and further increase skepticism about any security with the name of New York on it.

Now the State of New York has made huge investments to temporarily ease the situation in New York City. But if New York City defaults the entire financial structure of the government of the State of New York is put in jeopardy—not my words, but the testimony is here. I'm not here to testify for New York. I'm here to testify for the country, for the banking system of this country, for the municipalities of this country, because the problems extend beyond the boundaries of any one State or city.

Interest rates in the municipal bond market have soared to usurious levels. Yesterday the Chairman of the Federal Reserve Board said the last 2 weeks had shown unbelievable increases in interest rates on municipals that are tax exempt. I won't go down through the list of them, but they are going to 10 percent. Incredible.

We had a panel of 13 mayors testify before the JEC. What did they say? They were from all over the United States. They weren't in here testifying for New York. They were testifying for themselves. They realized very early that a policy of default would be penny

wise and dollar foolish. It wasn't with any great affection or benevolence for New York City that precipitated this supportive testimony but a clear appreciation of the fact that the uncertainty caused by New York's financial crisis was costing all of them millions and millions of dollars. As Senator Jackson pointed out here a moment ago, a 1-percent increase in municipal bond rates on the amount of outstanding bonds would be equivalent to a \$2 billion increase in interest that has to be borne by the people of the municipalities that are A-1 credit ratings.

You poison the whole thing. I tell you, it's like putting poison in the well from whence we all have to drink. Now once that's done, everybody gets a little sick. There's even a real threat that a default by New York City would seriously weaken the economic recovery now underway. Who testified to that? Chairman Burns. Who else testified to it? Helmut Schmidt, the Chancellor of the Federal Republic of Germany who is considered to be one of the most able financial experts in the Western World. The New York Times yesterday contained an article which cited quotations from several international economic experts warning of the international repercussions of such a default. As you said here yesterday, Mr. Chairman, it was a bank in Austria that failed in the early 1930's that precipitated a total collapse of the financial markets. I can't even remember its name. This is a very delicate, sensitive operation.

I'm proposing legislation which has been discussed by others. Several members of this committee have contributed to this legislation. It's not original. None of you necessarily wish to take the responsibility for it, but at least you have made an input as Chairman Burns did yesterday. I am introducing legislation that would enact the Intergovernmental Emergency Assistance Act. It provides a simple and reasonable mechanism for averting municipal defaults and bankruptcies and the serious consequences that could ensue. It is simple so that it can be implemented quickly to meet the immediate crisis. Yesterday Chairman Burns said if the Congress is to act it must do it promptly. Chairman Burns further said that while as of yesterday he would not favor Federal legislation, he said it was his responsibility to deal with the facts and not be locked into a position. I believe that the testimony yesterday of the Chairman of the Federal Reserve Board indicates that he's watching the facts very carefully and the facts are not at all encouraging.

My bill would establish an Emergency Intergovernmental Assistance Board of five members: the Secretary of the Treasury, the Secretary of Housing and Urban Development, and three members appointed by the President with the advice and consent of the Senate. The Board will determine by majority vote the eligibility of jurisdictions that apply for assistance. If the Board approves an applicant its recommendation is passed to the Secretary of the Treasury who must then provide assistance through a guarantee of taxable State or local government general obligation bonds.

Any city will be eligible when it fails in a bona fide attempt to obtain private financing. The Board, made up of the five appointed by the President, will determine whether or not a bona fide effort has been made to obtain private financing. Local governments must apply with the approval of the State, have failed in an attempt to obtain private

financing, be certified by the State that all State remedies have been exhausted, and that further State assistance will jeopardize the credit worthiness of the State. Through these provisions we are assured that all reasonable non-Federal remedies have been exhausted.

The major prerequisite for assistance under my proposal is that each State must submit to the Board for itself or for the eligible local government a 3-year financial plan. The plan shall detail the applicant's projected revenues, expenditures, scheduled borrowings and other information as the Board shall require. The plan, which the State will be responsible for enforcing—mind you we hold accountable the State—must also contain specific proposals to assure the achievement of the balanced operating budget within 2 years; (2) a specific proposal for the retirement of the applicant's noncurrent short-term debt; (3) specific assurances that the State will allow the eligible government to raise whatever taxes are necessary to avert default; in other words, self-help—and—no expenditures or borrowing will be permitted unless they are included in the plan.

Any State which fails to enforce the provisions of the plan would have its entire revenue-sharing payment from the Federal Government withheld until compliance is achieved. Now I tell you that's strong discipline. I do not believe in a bail-out. I do not believe in a handout. I do not want to see this become anything that will lead to more and more municipalities coming to the Federal Treasury.

My provisions in this bill are tough. They are stringent. They are strict. They are spartan. They require the local government to have exhausted every means, including tightening up on its budget, including State control of its finances, including if you please a program in 2 years to put the city's obligations and revenues in balance. All the restrictions and limitations that I think are reasonable and feasible—These are the provisions that have been testified to by the Chairman of the Federal Reserve Board.

I have left out only one and I'm sure the committee will want to consider it. The Chairman said that he thought that the State ought to have a special tax that would fund 50 percent of the operating deficit of the city. I didn't include that because many States today may not be able to handle that. For example, New York State itself may have some trouble. But this is a matter for the committee to consider.

Finally, this approach conforms very closely to testimony before the Joint Economic Committee. While Chairman Burns did not advocate Federal assistance at this date, I remind you he did not rule it out. But as of this time, he did suggest that any assistance program should include the following elements: strict limitations should be placed on eligibility to that Federal assistance is targeted only on cities and States in dire financial distress; (2) the State should supervise the management of the city; (3) the Federal Government should require a strict financial plan with no expenditures or borrowings permitted that are not included in the plan; (4) a fee should be paid to the Treasury for the right to assistance; and (5) a State tax should be leveled to pay one-half of the annual operating deficit of the eligible unit of government.

My proposal includes all of those provisions with the exception of the last. However, my proposal does say that the State should give

the city additional taxing power over and beyond what it may ordinarily have in order to take care of as many of its needs as possible.

Now I have tried to keep within reasonable limits of time, Mr. Chairman, but I want to conclude on this basis. We are playing here with fire that could spread. This country has a fragile recovery. I want to remind this committee that many banks in this country are overloaned. I want to remind this committee that these securities of New York City are held by some of the largest banks. I remind you that the big banks have been in to testify that something has to be done and the reason that they are testifying that the Federal Government has to do something is that they know that if New York City defaults that they may be in jeopardy. All you've got to have is two or three of these big ones start to fall apart and the entire banking structure of this country will be in a serious situation.

Then we'll come rushing to the Federal Reserve System. They will open the discount window. There will be unlimited amounts of credit while jeopardizes again the money markets which really throws the economy into an uproar.

Why can't we take preventive action before bankruptcy or default is forced upon us? I submit to you that when top people internationally tell us that this could jeopardize their recovery because they are tied in so closely to us; when the Chase Manhattan Bank gives you information as to what's necessary, when the Chairman of the Federal Reserve comes down here and tells you that a default could seriously impair our recovery, I think that it's time to act.

Might I say that mayors and Governors and other public officials throughout the country have been making this case as well. I understand, may I say, that our good and distinguished friend, the Senator from Oregon, had some concern about other areas. I have a letter here from the State Treasurer of the State of Oregon. It was a copy of a letter addressed to the Honorable William Simon, Secretary of the Treasury.

The State Treasurer of Oregon is one of those who's very concerned. He says, "As the State Treasurer of the State of Oregon, and one of those most closely concerned with the vagaries of the municipal bond market, I am writing to you to express my concern about the course of events in New York City, both past and present."

Then he says, "I have, however, concluded that the State of Oregon paid at least one-eighth percent more because of the dislocation and disarray of the municipal bond market. That dislocation and disarray were, in fact, caused by the woes of New York City."

Then over on page 2, "the administration has considered, and apparently rejected, the concept of a guarantee which would strip away the tax-exempt status of the bonds. I believe that this should receive further consideration."

And he goes on to point out that something has to be done.

Now the question of what you want to do is another matter, but I am here to testify that we will imperil our recovery, we will jeopardize the municipal bond market, we will threaten the solvency of the banking structure of this country, and we could precipitate a major economic disaster unless something is done promptly—promptly—to alleviate the situation which plagues New York City and the State of New York at this time.

New York City is not a normal city in any way. When you've eliminated the residency requirements for welfare and you've got Eastern Airlines flying you've got problems. You have poor people by the thousands pouring into that city and you have people entering from the international community by the thousands. It's imperative that the Government of the United States have an interest in the port of entry to the United States. It would be incomprehensible to me that the French would let Paris go bankrupt or in default. It's incomprehensible to me that even Britain with all of its problems would let London be defaulted or go bankrupt. New York City is special in this country.

I am not here as a resident of New York or as a citizen. I am a former mayor of the city of Minneapolis, and I will tell you something; the city of Minneapolis is suffering today because of New York City's potential default. There isn't a Senator in this body or a Member of the House that ultimately will not feel the repercussions in his or her State or district of a default on the part of New York City.

Now you just may talk about how much money we're going to spend, but if New York defaults bond rates go up, taxpayers will pay.

Taxpayers pay the interest on the city bonds, taxpayers pay the interest on State bonds, and quite honestly, all we're talking about here is a guarantee of a loan—a loan guarantee of some kind or an insured loan of some kind that will be under the most strict terms of repayment and of sound fiscal management.

I would hope that this committee would see fit to do something about it.

The Chairman. Thank you very, very much, Senator Humphrey. I want to thank you on behalf of all the members of the committee. I know that some members vigorously disagree with you and some enthusiastically agree.

I'd say just two things. One is that you have made a very constructive proposal to us, a very thoughtful proposal, one that I think helps us greatly in proceeding; and second, in all the years I have been sitting in hearings, this is as stirring and persuasive a presentation as I have ever heard. Thank you very much.

Senator HUMPHREY. May I ask, Mr. Chairman, that the letter to which I referred—because I'm sure Senator Packwood would want to see the letter—be included in the record, as well as a copy of the bill, the description of the bill, and the full body of testimony?

The CHAIRMAN. Very good.

(Complete statement and documents follow:)

STATEMENT OF HUBERT H. HUMPHREY, U.S. SENATOR FROM THE STATE OF MINNESOTA

Mr. Chairman and Distinguished Colleagues: I appreciate the opportunity to appear before this distinguished Committee and to present my views on New York City's financial crisis. In my testimony today, I will focus briefly on the scope of New York's financial problems and then discuss in greater detail the legislation that I will introduce today on the floor of the Senate.

I must confess that the subject of the Committee's deliberations is one of the most complex that I have confronted in my many years of public service. Uncertainties abound at every turn and few have been able to sort fact from fallacy. Even the most distinguished experts have been unable or unwilling to clearly and substantively identify the scope and dimensions of the problem. Yet, every possible public solution, including the "do-nothing-until-default" alternative advocated by the Administration, carries with it great risks and undetermined liabilities.

In fact, if one examines this issue more carefully, it is clear that the question before your Committee is not "Should the Federal Government provide assistance to New York City?", but rather, "Should the Federal Government provide assistance before or after default?"

Let me explain to the Committee what I mean by this statement. If the Federal Government does not assist New York City by mid-December, the city will most probably default on its obligations before the end of the year. But the act of default will not eliminate the need for the city to borrow. The city will have to borrow approximately \$1 billion in January, February, and March in anticipation of real revenues that will be received later in the fiscal year.

In addition, the city will have to borrow to help cover the deficit this year—a borrowing which even those who are calling for large cuts in the operating budget of the city realize is necessary. If the city cannot obtain these funds—which is most probably if the city were in default, it would simply be unable to meet payrolls, to issue assistance checks and to provide services. Clearly, the result would be chaos. At this point, the Federal Government would have no choice but intercede.

It is this fact of life which causes me to conclude that there is no constructive purpose to be served by default. Federal assistance will be necessary even subsequent to default. In fact, the need for Federal assistance may even be greater if the effects of default are as serious as some have projected.

The subject of today's hearing is undoubtedly one whose significance extends far beyond the boundaries of New York City and New York State. To be sure, the 8 million Americans who reside within the boundaries of the city will be most directly affected. Even without default, they face significant cutbacks in services, freezes on employee wages, and work force reductions which will undoubtedly have a severe impact on the regional economy. In fact, most of these steps have already been taken. However, with default, even in the best of worlds, the consequences for the city would be unfathomable.

This issue becomes all the more serious when it is recognized that the State is now involved in the finances of the city. It is likely that the mere existence of default will greatly jeopardize the State's own ability to obtain financing in the capital markets. We must all understand that the State will have to borrow up to \$4 billion for its own purposes and functions by June 1976, a feat which would be improbable should the city default and further increase skepticism about any security with the name New York on it.

But the problems extend far beyond the boundaries of the city and the state. Interest rates in the municipal bond market have soared to usurious levels. A few cities have even had to pay above ten percent interest on a tax exempt security. Ironically, these cities are really just innocent victims of the uncertainty caused by the New York City situation. These cities are not fiscally irresponsible. They are not bad credit risks. They do not have huge operating deficits. They are simply victims of a situation over which they have no control.

We had a panel of thirteen Mayors testify two weeks ago before the Joint Economic Committee in support of Federal aid to New York City. Mayors came from all over the country, from the central cities and the suburbs. They could easily have said, "this is a New York problem and we don't want to get involved." But they realized very early that such a policy would be penny wise and dollar-foolish. It wasn't any great affection or benevolence for New York City that precipitated their supportive testimony, but a clear appreciation of the fact that the uncertainty caused by New York's financial crisis was costing all of them millions of dollars—not just this year but for many to come.

There is even a very real threat that a default by New York City could seriously weaken the economic recovery that is now underway. Yesterday, Chairman Arthur Burns of the Federal Reserve System testified before the Joint Economic Committee and said, "I recognize that a default, besides being a very serious matter for the City and State of New York could have troublesome consequences for the Nation at large." It is certainly conceivable that interest rates will rise if the city should default, putting a crimp into many investment plans. Moreover, lending institutions that own a large number of municipal bonds will undoubtedly be very cautious in their extensions of credit.

We have even seen the first examples of international concern about New York City's financial crisis. Last week, Helmut Schmidt, Chancellor of West Germany, warned of an international "domino effect" should New York City be allowed to default. Yesterday, the *New York Times* contained an article which cited quotations from several international economic experts warning of the international repercussions of a default. To quote just one, Christopher Gruebles, a director

of the Union Bank of Switzerland, "We feel that it (default) would seriously affect capital markets and might also affect the dollar."

The legislation that I am introducing today, the Intergovernmental Emergency Assistance Act, provides a simple and reasonable mechanism for averting municipal defaults and bankruptcies and the serious consequences that would ensue.

It is simple so that it can be implemented quickly to meet the immediate crisis. Yet, the requirements that it imposes are sufficiently stringent that only the worst cases will apply and qualify.

The bill establishes an Emergency Intergovernmental Assistance Board composed of five members—the Secretary of the Treasury, the Secretary of Housing and Urban Development, and three members appointed by the President with the advice and consent of Congress. The Board will determine, by majority vote, the eligibility of jurisdictions that apply for assistance.

If the Board approves an applicant, its recommendation is passed on to the Secretary of the Treasury who must then provide assistance through a guarantee of a taxable state or local government general obligation bond.

Any state will be eligible when it fails in a bona fide attempt to obtain private financing. Local governments must (a) apply with the approval of a state; (b) have failed in an attempt to obtain private financing; and (c) be certified by the state that all state remedies have been exhausted and that further state assistance will jeopardize the credit-worthiness of the state. Through these provisions we are assured that all reasonable non-Federal remedies have been exhausted.

The major prerequisite for assistance under my proposal is that each state must submit to the Board, for itself, or for the eligible local government, a three-year financial plan. The plan shall detail the applicant's projected revenues, expenditures, scheduled borrowings and other information as the Board shall require. The plan, which the State will be responsible for enforcing, must also contain (a) specific proposals to assure the achievement of a balanced operating budget within two years, (b) specific proposals for the retirement of the applicant's non-current short-term debt, and (c) specific assurances that the state will allow the eligible local government to raise whatever taxes are necessary to avert default. No expenditures or borrowing will be permitted unless they are included in the plan. Any state which failed to enforce the provisions of the plan would have its entire revenue sharing payment withheld until compliance is achieved.

It is these strong financial controls which make it unlikely that many governments will participate in the program. No local government will be willing to give up the power of the purse to the state unless its very survival is at stake.

The approach that this legislation takes, conforms very closely to the approach that Chairman Arthur Burns of the Federal Reserve System suggested in testimony before the Joint Economic Committee yesterday. While Chairman Burns did not advocate Federal assistance at this time, he did suggest that any assistance program should include the following elements:

(1) Strict limitations should be placed on eligibility so that Federal assistance is targeted only on cities and states in financial distress;

(2) the state should supervise the management of the city;

(3) the Federal government should require a strict financial plan with no expenditures or borrowings permitted that are not included in the plan;

(4) a fee should be paid to the Treasury for the right to assistance; and

(5) a state tax should be levied to pay one-half of the annual operating deficit of the eligible unit of government.

The bill that I offer today incorporates four of these five elements. First, since an eligible government must issue taxable, rather than tax exempt securities, it will pay a higher interest rate for its borrowing. This higher interest rate, combined with the relinquishing of the power of the purse, will prevent all but the hardship cases from applying. Second, the state will be responsible for approving and enforcing all of the elements of the plan, thus taking over the management of the city. Third, the approval of a strict financial plan is a clear prerequisite for receiving assistance under my legislation. Fourth, the legislation that I am introducing today imposes a fee of one percent for administrative and guarantee expenses.

The bill does not incorporate a special one-year state tax because I believe a significant tax increase may be too difficult for the state to bear in the current recession. However, I would not rule out this suggestion if it could somehow be made less onerous and the economic impact thus reduced. My bill does take as

collateral the state's revenue sharing payment, which, in my opinion, is a negative sanction of comparable amounts.

The advantages of the bill, however, go well beyond the requirements that Dr. Burns mentions.

First, it is a temporary solution to a short-term problem. The bill is not a substitute for normal revenue collections. It will not affect existing activities in the tax exempt market. Rather, it will temporarily supplement the tax exempt market in those few cases where the market cannot meet the financial needs.

Second, the program is very carefully targeted to assist only the most financially strained states and municipalities. It requires that the state or city fail in a bona fide attempt to obtain private financing, thus limiting the program essentially to those states and cities that have lost their line of credit completely. Further, the interest cost of these notes will be above all but the most distressed bids in the tax exempt market, screening out all states and cities that can obtain reasonable private financing. In addition, as I mentioned earlier, the city would be giving up control of its budget.

Third, the requirement for a strict financial plan for balancing the city or state's budget and retiring its outstanding short-term notes develops a partnership in which the city, state, and Federal governments are working together to solve the recession-induced fiscal problems. This plan prevents the Federal government from essentially taking over the management of the city. Development of the plan and control over finances is left to the state. On the other hand, the plan insures that the Federal government will not be caught holding the bag of bad debts that no one else would reasonably purchase.

Fourth, this legislation incorporates a simple mechanism that can be quickly implemented, thus dealing with immediate crises that require immediate solutions.

Fifth, this legislation will have a very positive impact on issues in the tax exempt market. It will significantly reduce the supply and demand pressures in the tax exempt market, thus improving the bids for bonds and notes of all other states and cities. More important, however, it will temporarily remove from the tax exempt market those bonds and notes which are creating the greatest uncertainties in the market and thus the greatest skepticism about tax exempt securities.

Finally, the bill will actually make money for the Treasury by closing up the tax expenditure that tax exemption normally provides to the purchasers of these securities. The annual gain to the Treasury could be as much as \$400 million. To be honest, there would be an offsetting rise in Treasury borrowing costs since this will would expand the supply of Federal government securities.

I feel compelled to discuss frankly and honestly the total value of the securities that the Federal government must guarantee. The estimates of the Joint Economic Committee staff indicate that as much as \$10 billion worth of city and state securities will have to be guaranteed to avoid a major default. This is no doubt a large sum of money, but there is no half solution to this problem. Anything less than this amount will merely delay default for six months, and at that point, the Federal government will be holding the bag.

However, the Federal government's actual liability is certainly far less than this amount. If we can judge from the experience of RFC loans to state and local governments in the 1930's, we will probably experience losses of less than one percent. More important than this historical precedent, however, is the fact that the city and state revenue bases are simply not going to disappear. In fact, the bill that I have introduced specifically mandates that states allow cities to raise taxes in order to avert default. This provision protects the Federal investment.

In the case of New York, we must take special note of the fact that the city pays approximately \$1.6 billion in debt service annually. So, even if the Federal government did guarantee \$7 to \$8 billion of city bonds, we could reasonably expect to retire this debt within a ten year period.

The legislation that I introduce today is a reasonable and fiscally sound proposal to deal with a problem that we simply cannot afford to ignore. There may be other proposals that warrant the attention of the Committee—possibly direct loans or insured loans. But, I urge all of the Members of this Committee to give this legislation careful consideration so that we can act before it is too late.

Thank you.

[S. 2514, 94th Cong., 1st sess.]

A BILL To establish an Emergency Intergovernmental Assistance Board, and for other purposes

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Emergency Intergovernmental Assistance Act of 1975".*

## DEFINITIONS

SEC. 2. For the purposes of this Act—

- (1) "general local government" means a city, town, county, or other general purpose subdivision of a State;
- (2) "State" means a State of the United States, the District of Columbia, and the Commonwealth of Puerto Rico;
- (3) "applicant" means any State or general local government which has filed an application for assistance under the provisions of this Act.

## ESTABLISHMENT OF BOARD

SEC. 3. (a) There is established in the executive branch of the Government, an Emergency Intergovernmental Assistance Board (hereinafter referred to as the "Board") which shall have succession for a period of four years from the date of enactment of this Act. The Board shall be composed of the Secretary of the Treasury, the Secretary of Housing and Urban Development, and three other members who are well qualified by training and experience to execute the duties of the Board, and who shall be appointed by the President, by and with the advice and consent of the Senate.

(b) Members of the Board from private life shall serve for a term of four years, and any such member appointed to fill a vacancy shall be appointed only for the unexpired portion of the term. Each member of the Board from private life shall each be entitled to receive compensation at the daily equivalent of the annual rate of basic pay for grade GS-18 of the General Schedule for each day (including traveltime) during which he is engaged in the actual performance of his duties as a member of the Board.

(c) While away from their homes or regular places of business in the performance of services for the Board, members of the Board shall be allowed travel expenses, including per diem in lieu of subsistence, in the same manner as persons employed intermittently in the Government service are allowed expenses under section 5703(b) of title 5, United States Code.

## FUNCTIONS

SEC. 4. It shall be the function of the Board to determine the eligibility of and approve applicants for assistance under this Act. Such determination shall be made by a majority vote of the Board after review of information submitted by an applicant in accordance with the standards established by section 5 of this Act. Such determination shall be made by the Board within ten days of the receipt of an application for assistance under this Act. Notification of a determination by the Board of the eligibility of an applicant shall be promptly transmitted to the Secretary of the Treasury.

## AUTHORIZATION

SEC. 5. (a) Upon notification pursuant to section 3, the Secretary of the Treasury shall, upon terms and conditions prescribed by the Board, guarantee, or enter into a commitment to guarantee, holders of obligations issued by the applicant against loss of principal or interest payable on such obligations.

(b) There are authorized to be appropriated such sums as may be necessary to carry out the provisions of this Act.

## STANDARDS AND CONDITIONS

SEC. 6. (a) To be eligible for assistance under this Act, an applicant must demonstrate to the satisfaction of the Board that—

- (1) it has made a bona fide attempt to obtain private financial assistance and has failed in such attempt; and

(2) if the applicant is a unit of general loyal government, it has exhausted all attempts to obtain State assistance which the State can reasonably extend without damaging its own credit posture.

(b) No guarantee shall be made under this section unless the Board finds that—

(1) the obligation guarantee is necessary to the continued operation of the applicant; and

(2) the guaranteed obligation will be secured by the full faith and credit of the applicant which shall be recited and appear on the face thereof.

(c) Any obligation guaranteed by the Secretary shall become due and payable in full at any time not to exceed ten years from the date of such obligation and shall be conditioned on the payment of a fee, not in excess of 1 per centum, to the Treasury by the recipient of the obligation guarantee in an amount sufficient to create a reserve against losses or defaults and to cover administrative expenses.

(d) Interest on obligations guaranteed under this Act shall not be tax exempt.

(e) If the applicant is a State, it shall furnish to the Board and the Secretary, and if the applicant is a general local government under the jurisdiction of such State, it shall furnish through that State with the endorsement of the Governor thereof, a plan which, subsequent to its initial submission by the applicant, may be amended by a majority vote of the Board, detailing the applicant's projected revenues, expenditures, scheduled borrowings, debt service costs, and such other information as the Board may require for a period of three years after the date of anticipated assistance under this Act. Such plan shall also contain—

(1) specific proposals designed to assure achievement of a balanced operating budget under standard accounting practices within two years of the receipt of assistance under this Act;

(2) a specific program for retirement of the applicant's existing non-current short-term debt; and

(3) such specific assurances as the Board may require that the State will take such legislative action as may be necessary to permit applicants which are units of general local government to utilize such lawful revenue devices as may be necessary to avoid default upon the general obligations issued by such applicants.

No expenditures or borrowings shall be made by any applicant during the period of its assistance under this Act which are not specifically contained in the plan submitted under this subsection.

(f) If any State which is an applicant or endorser under subsection (e) fails to take such measures as may be necessary to insure compliance with a plan filed with the Board under subsection (e), and with such standard accounting procedures and limitations on expenditures and borrowings, as the State may require, such State shall—

(1) have its entitlement under the State and Local Fiscal Assistance Act of 1972, or other comparable general purpose financial assistance from the Federal Government, as determined by the Secretary, withheld until such time as the Board is satisfied that such State is taking all practicable steps to assure that such obligations and undertakings as are set forth in the plan required by subsection (e) of this section are being met; or

(2) shall be assessed a civil penalty equal to such sums to which the State was entitled under the State and Local Fiscal Assistance Act of 1972 for the fiscal years ending June 30, 1973, June 30, 1974, and June 30, 1975.

(g) The Secretary shall consult, as necessary, with any State or general local government which has received assistance under this Act concerning any matter which may bear upon the ability of the unit of government to repay the obligation within the time fixed therefor and reasonable protection to the United States.

#### DESCRIPTION OF BILL

*Title.*—Emergency Intergovernmental Assistance Act of 1975.

*General Description.*—The bill establishes an Emergency Intergovernmental Assistance Board composed of five members—the Secretary of the Treasury, the Secretary of HUD, and three members with outstanding private experience appointed by the President with the advice and consent of the Senate. The Board will determine, by majority vote, whether jurisdictions are eligible for assistance provided under this Act. The Board will have not to exceed ten days from the

date of application in which to make this decision. If the Board votes in favor of assistance, this recommendation is then passed on to the Secretary of the Treasury who shall provide assistance by guaranteeing a taxable bond issued by the eligible state or local government. The Secretary has no discretion as to whether to provide assistance once the Board has voted favorably.

*Eligible Governments.*—Any state or general purpose unit of local government will be eligible for this assistance. In the case of a local government, the state will also have to participate in the application (see Other Requirements). In order to be eligible for assistance, the state or local government must have failed in a bonafide attempt to obtain private financing. In addition, in the case of a local government, the state would have to show that it had provided as much assistance to the local government as is feasible without jeopardizing the State's own credit worthiness.

*Eligible Securities.*—Any taxable bond guaranteed by the Federal government would have to be backed by the full faith and credit of the issuing government.

*Maturities of Guarantees.*—The guarantees could be offered on securities with maturities of up to ten years.

*Interest Rate, Fees and Charges.*—The guaranteed taxable bonds will have their interest rate set by the market, but will also require a service fee of up to one percent.

*Other requirements: Financial plan.*—As a prerequisite for the provision of assistance under this Act, each eligible state or local government must submit to the Board and the Secretary of the Treasury a three-year plan detailing the applicants projected revenues, expenditures, scheduled borrowings, debt service costs and other information that the Board may require. In the case of a local government, the State would be required (through the endorsement of the Governor) to sign onto and participate in the enforcement of the plan. The plan must also contain (a) specific proposals to assure the achievement of a balanced operating budget within two years of receipt of the initial assistance under this Act, (b) a specific program for the retirement of the applicant's non-current short-term debt and (c) specific assurances that the State will permit the applying local government to use any lawful revenue raising mechanisms that may be necessary to avert default on the guaranteed obligations.

No expenditures or borrowings would be permitted that were not specifically included in the plan.

The Board can approve by majority vote any amendments to the plan.

Any State that failed to enforce a plan that it had endorsed would have its revenue sharing payment (or other general purpose financial assistance) withheld until it was once again in compliance with the requirements of the Act.

STATE OF OREGON,  
TREASURY DEPARTMENT,  
Salem, September 26, 1975.

HON. WILLIAM SIMON,  
Secretary of the Treasury,  
Washington, D.C.

DEAR SECRETARY SIMON: As the State Treasurer of the State of Oregon, and one of those most closely concerned with the vagaries of the Municipal Bond market, I am writing to you to express my concern about the course of events in New York City, both past and present.

I recently read an article in a local newspaper headlined: "Simon Throws New York to the Wolves." I was even more distressed when I read the text of the article which legitimized that headline.

I write because I wonder if you have fully considered the implications of a major default by the City of New York. I hope that you will bear with me, so that I can explain the viewpoint of a state official that has no ties with the politics of that city.

You have been quoted as saying that the present situation has not had an affect outside of the City of New York, and that a default by the City will not have an adverse affect but will, in fact, have a beneficial effect on the balance of governmental units in this nation. How could that be? Last May, the State of Oregon sold a \$125 million bond issue for the benefit of our veterans' housing program. Those bonds were rated AAA by Moody's Rating Service and AA by Standard and Poors'. This established housing program is, probably the most successful public housing program in the United States. Oregonians are justly proud. The bonds were sold at 6.024%. The previous issue, of the same amount, sold at 5.190%. I do not attribute the financial woes of the City of New York

for the entire difference in those rates. Obviously, many factors go into that determination. I have, however, concluded that the State of Oregon paid at least  $\frac{1}{8}\%$  more because of the dislocation and disarray of the municipal bond market. That dislocation and disarray were, in fact, caused by the woes of New York City.

There are few of us, concerned with the municipal market, that would suggest that the federal government simply bail the City out. There are few who believe that an outright federal guarantee for future issues of "Big Mac" would be a logical solution. There are other avenues, however, that should be considered. The Administration has considered, and apparently rejected, the concept of a guarantee which would strip away the tax exempt status of the bonds. I believe that this should receive further consideration. The one benefit of this plan, as far as municipalities are concerned, is that the tax exempt market would not be totally occupied by those particular issues.

Another approach might be to guarantee those bonds only if purchased by bond buyers who do not customarily purchase tax exempt paper. An example would be the various public and private pension funds operating on a tax exempt status. Approaches such as these, coupled with increased federal take over of welfare expenditures by the City, would be of assistance.

I firmly believe that any such assistance must be met with supervised guarantees by the City of New York that their fiscal house will be kept in order.

I believe that many citizens in this nation wonder why the federal government is willing to "save" a Penn Central Railroad, Lockheed and Franklin National. There may be logical reasons, but they are most difficult to explain.

I also believe that the problems unique to the City of New York must be considered when determining the possibility of assistance. No one can deny fiscal gimmickry on the part of the managers of the City. It is true, however, that their problems are magnified as compared to other cities and states of this union. The fact that federal and state taxation systems remove more dollars from New York than they replace, is also worth consideration.

I realize that there is a school of thought that a default on the part of New York City will somehow cleanse the municipal soul and, hence, be of lasting benefit to us all. I doubt that this is so. The effect on the municipal market, short of default, has been adverse. A default could be disastrous.

I strongly urge that the expertise within the administration be marshalled to decide how best to succeed in assisting New York City, rather than simply stating the reasons why this should not or cannot be done.

Very truly yours,

JAMES A. REDDEN.

Senator HUMPHREY. I'm sorry that I came late here, but I'm managing a bill on the floor.

The CHAIRMAN. We understand and we appreciate that.

Senator TOWER. I know we agreed to hold questions, but I just have to say I profoundly disagree with some of the premises on which my distinguished colleague from Minnesota proceeded.

Senator HUMPHREY. One of my problems, Senator Tower, is these very frank disagreements with you, for whom I hold great respect. However, I do pray for you and you pray for me.

[Laughter.]

The CHAIRMAN. Secretary Simon, you're a much put upon man. You're wonderful to come down. We realize you have an appointment. We apologize for delaying you so long. You're very patient as well as extraordinarily able.

### STATEMENT OF WILLIAM E. SIMON, SECRETARY OF THE TREASURY

Secretary SIMON. Mr. Chairman, I'd like to say a couple of things at the outset before I get into my prepared statement. I have been sitting here for a little while listening to a lot of the comments and a lot of the questions and I'd like to comment on a couple things.

I'd like to start out by saying one thing. Yes, we have a serious problem. These hearings and all of the debate that has occurred over the summer months dramatizes the potential seriousness of the problem. There is also a very great difference of opinion on what the effects might be, what the financial impact is, but I think that there have been a lot of irresponsible statements and statements that show a lack of knowledge of the subject. If I may, I'd like to comment on just a few of those.

I did not, and to the best of my knowledge Arthur Burns did not, testify to the fact that Franklin National Bank was bailed out. The Federal Government and the Federal Reserve System are not in the business of bailing out banks. I went to great pains, I thought, at the JEC a couple weeks ago in explaining what the function of the Federal Reserve System is vis-a-vis the banks.

Let me begin by noting that Franklin National Bank went bankrupt. Its equity holders and its bond holders lost their money. But the function of the Federal Reserve System is to protect the depositors of the institution against a potential run. They only lend money on a collateralized, fully secured, basis while they are arranging for the merger which ultimately occurred. Not one depositor lost 1 penny. I would hope that the misconception that's being put forth to the American people—that the Federal Government is in the business of bailing out banks—can be corrected. If indeed there were to be insolvency problems due to the New York City situation, the banks which had the problem would suffer the financial consequences. The Federal position as I just explained is clear.

Now as far as someone testifying on the insolvency of New York City banks, he's making many assumptions, most of them incorrect: (A) assuming what the market price of a defaulted security would be, (B) assuming that the default would be permanent and not corrected; and (C) assuming something that the figures do not substantiate.

About 10 percent of the capital and surplus of the New York City banks is in New York City paper. That is approximately 0.6 of 1 percent of the total assets of these banks and I think those figures explain very dramatically what the effect would be. While it has a financial effect, yes; insolvency, I'm sorry. We have data on all banks in the United States and their percentage of holding on capital and equity on total assets. We're very well aware of those that are a potential problem and we have outlined our steps in previous testimony as to what should be done.

On another subject, the subject of interest rates going up, Mr. Packwood and Senator Jackson had a spirited debate on interest rates and indeed it was pursued with Senator Humphrey, as to the impact that this is having: The unsettling impact on the market. There's absolutely no doubt about that. That's been agreed to right from the beginning. Senator Jackson talked about my former partner, Henry Kaufman, and I share his respect for Henry. I think he's probably the finest economist, financial economist in the United States of America. Yesterday he came out with a study that illustrates the spread between tax exempts and taxables. I would like to put it into the record. What it illustrates is that the medium grade municipal yield relationships to taxables—and this is important—have changed little on balance. Then it goes on to explain how in some instances it's even

better than it was in 1970 and 1971. This is the subsidy that our States and municipalities get, the approximately 30 percent subsidy due to the fact that their securities are tax exempt.

As far as the welfare share of New York City, we have a formula under Federal law—our share of welfare runs from 50 to 80 percent, based on per capita income of the State. New York State, as one of the wealthiest, gets 50 percent Federal payments. Mississippi, as one of the poorest, gets 80 percent. The balance, the other 50 percent, is paid by New York State. The State determines what the city share shall be, not the Federal Government. Our share is set by a formula and, as I say, we should take another look at all of these programs and the formula and if changes are needed they should be made. I have been accused of being callous in one recent editorial in the last week, accused me of being flippant, and I just want to assure you, Mr. Chairman, and gentlemen, that the Secretary of the Treasury is not flippant on this issue. He is giving you his best judgment, recognizing there are other people in the marketplace who are going to differ. That's what markets are all about. We have some people who think markets are going up and others who think they are going down. The judgments are highly subjective in nature and certainly this whole situation has had an effect on the market. Interest rates have gone up because all interest rates in the market have gone up due to inflation and our heavy borrowings. Certain categories of cities, cities which have fiscal problems may be impacted because we have had a flight to quality since the Penn Central bankruptcy 4 years ago. Investors are now demanding more information, the financials, where heretofore general obligations of cities and States were never questioned. Now they want the information to make sure that their money that they invest is indeed going to be secure.

Now I can speak to the specifics of displacements which I will under your questioning. From the beginning of September until right now there have been 10 displacements. Seven of them sold within the next few days at interest rates within proper limits depending on their quality. Two others had to be cut back in size due to credit considerations.

I heard toward the end of the comments that commercial banks are oversaved. Loans to commercial banks proposed by commercial banks this year have declined in excess I believe—I don't have the exact number with me—of \$2 billion. The loan-to-asset ratio of our commercial banks has been put back into shape for the last 20 years. The Federal Reserve has been very diligent in this and I would suggest the loan-to-asset ratio is not out of line with historical levels.

With those few remarks, I would like if I can—I will move through this testimony. I will urge you, if you could, Mr. Chairman and gentlemen, to please read it in its entirety and I will skip whatever I can in the interest of brevity so we can get to some questions.

Today we move from study, investigation and evaluation into the infinitely more demanding process of considering specific legislative responses. And as we make this transition, it becomes all the more important that the issues be dealt with in the serious and objective manner they deserve. Measured tones and deliberate analysis are imperatives. I have noted that there are two risks presented by a default: the financial and the psychological. I have often expressed the

view that the financial risk can be mitigated. But at the same time, I have been equally candid about our inability to measure the psychological impact, and about our concerns that dire predictions and vigorous rhetoric may compound whatever psychological risks do in fact exist. It is our joint responsibility to see to it that these concerns are minimized.

The proponents of the legislation pending before this committee believe that a major program of Federal financial assistance is warranted by the circumstances. I cannot agree. What is warranted, indeed required, is a comprehensive program of fiscal and financial reform in order to return New York City to the capital markets. There is a Federal role in this process but it is not the role envisioned by the legislation before us.

Before turning to the program of reform, let me summarize for the committee the current situation in New York City and New York State.

First, as a consequence of the events of the past month, the credit of New York State and its agencies has—rightly or wrongly—become intertwined with that of New York City. The State's bond rating has been reduced and the rating on certain of its notes withdrawn. These actions are not based primarily on concern with the fundamental finances of the State. Instead, they reflect the realities of the marketplace: investors currently are unwilling to purchase New York securities in the present atmosphere.

Second, potential inadequacies in the financial structure of the New York State Housing Finance Agency have come to light. The financial community has acted most responsibly in analyzing the finances of this agency and in presenting a proposal to the legislature designed to cure some of these difficulties. I believe it is important that this proposal be acted upon promptly.

All levels of government, and the private sector as well, share the responsibility for developing a workable program that will restore New York City's access, and that of the State as well, to the capital markets.

I then pretty much go through the program that I outlined in an interview last week, but let me just highlight it.

First, and foremost, New York City must adopt a credible balanced budget plan which provides for the prompt elimination of budget deficits.

The institutional framework is now in place, but the Emergency Financial Control Board and the new deputy mayor must now operate in concern, devoting all of their resources to implement the fiscal policies necessary to return the city to the market. Substantial additional expenditure cuts are required. Operating expenses must be eliminated from the capital budget.

Second, during the period of transition to balanced budget operations, the State should provide New York City with a temporary source of additional revenues, to avoid the accumulation of further deficits.

Such assistance should be provided by an emergency and temporary 1- or 2-year tax, perhaps an increase in the State sales tax. When New York City's budget has been restored to a sound fiscal basis, these funds can be repaid by the city over time through the State appropriation process.

Third, the financial and investment community must also play an important role.

If the city and State take the actions outlined above, if operating and capital expenditures are drastically reduced, and if pervasive control is exercised over the fiscal and financial affairs of local governments and agencies within the State, then it will be the financial community's own self-interest to help provide the requisite credit to protect investments made to date and to insure healthy markets in the future.

It may be that further commitments from the financial community and from investors may not be necessary. But if they are, certain actions may be appropriate.

Within the context of an orderly proceeding for the restructuring of New York City's debt, holders of short term securities may, if necessary, be asked to extend maturities for a short period—perhaps 2 to 4 years.

In addition, again only if necessary, the city's bondholders may be asked to agree to a moratorium on payments of interest and perhaps principal for a short period of time.

Once the threshold of budgetary control has been crossed, these actions can provide the bridge to return New York City to the capital markets. But any comprehensive program of reform must deal with longer range concerns as well. We in the Federal Government have a clear responsibility with respect to this part of the process.

As a fourth part of the program, the Federal Government must accelerate a comprehensive review of Federal, State, and local relationships. To put it bluntly, we must determine whether the priorities, practices, and procedures of the past are consistent with the needs of the last quarter of the 20th century.

Fifth, we must propose structural improvements in the municipal bond market. I than talk about the taxable bond proposal which was submitted to the Congress in 1973 which gives the option to mayors and governors to finance in the taxable market which in effect would broaden the market due to the fact that they can then appeal to pension funds, and so forth. I think it's a very important piece of legislation.

I go on to explain, as I did at the outset in my remarks, the traditional average of tax exempt and taxable securities and indeed that the traditional average exists today, illustrated, as I say, by what I'm putting in the record by Salomon Bros. and Henry Kaufman who was referred to earlier.

I then talk about the changing structure of the municipal market, how supply has doubled in recent years; that demand has not kept pace with supply.

Finally, partially in recognition of the growing participation of the smaller investor in the State and local bond market, we believe the time has come for a federally imposed uniform system of financial accounting and reporting by State and local issuers which sell a substantial amount of securities in our capital markets.

Then I talk about the flight to quality, realignment, again summarizing the various steps that should be taken. This is a program designed to attack the causes of the problem at their roots. But unlike the legislative proposals before us today, it is far more likely to return our greatest city—indeed all our cities—to a totally sound fiscal basis.

I then talk about the proposals that are before us today—guarantees, insurance, and so forth, as well as the Federal financing bank, as well as Senator Humphrey's suggestion of the national domestic development bank which I testified to Congress about I think 8 or 9 years ago in the urban development bank proposal. None of these proposals are really radically different from those proposals.

I then talk about objections, expansion of Federal credit and driving up borrowing costs, and the discipline of the market would be lost. I note that there is no difference between a guarantee and an insurance program.

Unfortunately, the private insurance companies, the largest of the two that are in the business, the maximum insurance that it will provide is \$20 million per issuing. That means if we do three-quarters, the total size of the issue of the Federal Government would be asked to guarantee would be \$80 million and this certainly would not assist anyone. So the reinsurance scheme is not applicable to the problems of today.

I then go on to talk about the other bills and our objections to the serious implications of the capital markets and restraints, and so forth.

Then I talk about the municipal bond market. Some think, incorrectly, that this market is distinct. It is not. It's an integral part of our capital market structure as a whole. The same things are happening in our capital markets as a whole, as I said at the outset. Things we warned about a year ago are happening in all markets, including the municipal bond market—higher rates, shorter maturities, crowding out of many additional marginal credits. Yield differentials between the stronger and the weaker credits, are at record highs. Recently the spread between A and Baa industrial bonds has been as high as 200 basis points; double the 1974 figures and four times greater than the 1971-73 average. Additional Federal credit in the market could cause these spreads to widen further. And if guaranteed bonds retained the tax-exempt feature, the impact on unguaranteed municipal issuers would be especially direct and could be severe.

These are the concerns of the Nation expressed in the Joint Economic Committee 2 weeks ago, but we think they misplaced the blame. Yes, I remember one mayor saying that his borrowing cost compared to 1973 has gone up by  $x$ . Well, so has everybody else's, and that's the problem with inflation. Any program of Federal assistance would further exacerbate these problems.

Then we talk about the Federal Government and what its function would be in managing State and local decisionmaking and what the State and local decisionmaking might be if we were to adopt one of these programs. While some have suggested the interposition of State control, I seriously doubt whether it would provide a viable alternative. There would be little reason for a State agency not to yield to the same pressures as a local government in the absence of discipline from the market or some other source.

We would have to create a new bureaucracy, and let there be no mistake, this would not be temporary and it would involve a labor bureaucracy.

On the guarantee side, as you have heard me say before, if we guaranteed tax exempts we would be creating a security even better than the Federal Government's. Those municipalities which did not wish to subject themselves to the criteria of the Secretary of the Treasury, which

would be his responsibility, would be forced to pay higher interest rates.

I then talk about the guaranteed bond and the penalty, the impact of default. We have talked today and concentrated on a variety of approaches in the financial situation in New York City and New York State. I believe the approach I have suggested is desirable and workable. I cannot support the approaches in the legislation before this committee.

To complete the analysis, however, it's necessary to discuss the consequences if none of the approaches is adopted. My views on the impact of a potential default haven't changed materially. I have always believed that a default would be highly undesirable, indeed awful. I have always believed that a default could and should be avoided by any appropriate means. But putting aside the rhetoric, putting aside the politics and putting aside for a moment the absolute desirability of avoiding a default, I cannot conclude that the default would devastate our financial markets or our economy.

At the same time, I have often underscored the importance of the psychological factors and our inability to predict the psychological impact with any certainty. We have been carefully monitoring the marketplace daily and we have noted the developing psychological impact of the marketplace. Restraint is of the utmost importance. I must point out that dire predictions of pending doom could well become self-fulfilling.

My views on the overall question of the impact of default are fully expressed in my testimony before the Joint Economic Committee and I do not need to repeat them in detail here. I do want to concentrate and expand upon one particular concern: the impact of a potential default on the ability of other State and local governments to raise necessary funds in the municipal market.

Earlier in my testimony I noted that municipal governments are facing the same pressures as all other borrowers: a diminishing supply of capital at higher and higher rates caused primarily by inflation and the growing Federal usurpation of the supply of credit in this country. I also mentioned that within the municipal market itself there are structural problems which need to be addressed as State and local capital requirements grow faster than the demand for tax-exempt securities. I have also noted that all investors are increasingly sensitive to quality consideration and are demanding more and more evidence of financial soundness.

Perhaps the most important factor in today's market is uncertainty, a psychological factor which markets do not tolerate well. A number of intermediaries and investors are, we understand, refusing to commit funds to the market—thus impairing the borrowing ability of many State and local governments—until the New York City situation is resolved. New York City's difficulties have been the major factor in the uncertainty and have intensified investor concern with quality. But New York's financial crisis did not create the other problems besetting the market, and an end to that crisis will not make them go away.

When I testified before the Joint Economic Committee and Senator Humphrey, I didn't realize at that time that he had been the mayor of Minneapolis. Minneapolis is a fine AAA city. Minneapolis sold on September 8 or 9 at 5.53 interest cost. Cities like Minneapolis, those who have run their financial and fiscal affairs properly, benefit from a

flight to quality. It is the borrower at the lower end of the spectrum that suffers, just as they do in the corporate market and in other markets.

So I don't believe that a default would precipitate a series of defaults by other cities throughout the country. No other city has had a cumulative deficit like New York City's and thus none must borrow simply to meet operating needs from year to year. To the extent other cities must borrow within a fiscal year to deal with seasonal cash flow variations, I cannot conclude that a default will materially impair their ability to do so. In short, either other cities have the money to pay their debts or they do not. Those which do should be able to obtain credit.

In asking ourselves what the impact of a default would be, we must also ask the correlary question of what would be the impact of various mechanisms to avoid default. If, for example, New York City were able to avoid default by implementation of the plan discussed at the beginning of my testimony, I believe that the result would be a renewed sense of faith in the ability of the State and local government sector and our financial institutions to deal with even the most severe problems in a responsible manner.

If, on the other hand, default were to be avoided by a Federal assistance program, the reaction could be more complex. Clearly, there would be no basis for concluding that avoidance of default meant that State and local governments were able to carry out their financial obligations. Just the contrary would be true. Meanwhile, there would be far more incentive for State and local governments to embark on more spending programs, irrespective of whether resources were available to finance them. The discipline built into the present system would be lost entirely.

What the Federal Government would do for New York, all would believe, it would necessarily do for any other jurisdiction which became unable to meet its obligations.

This committee faces some difficult choices. The risks of a default, in the final analysis, are unknown and unknowable. My own judgment is that such risks should be manageable. Moreover, as I have indicated in my testimony today, the proposals pending before the committee present a series of concerns which outweigh the risks as I perceive them.

Mr. Chairman, I would like to conclude my remarks today with some purely personal observations. It has been nearly 7 months to the day that the city's bankers reached the conclusion that a market no longer existed for the securities of the city. For this entire period, the citizens of the greatest city in the world—its financial, industrial, and cultural hub—have lived from crisis to crisis. As one with deep personal and professional ties to New York City, I have great compassion for the plight of the citizens of New York and I share their determination to achieve a prompt and proper end to the crisis.

Over this period much in the way of laudable progress has been made. An "untouchable" expenditure increase for fiscal year 1975-76 was pared somewhat. The inexorable growth in the municipal payroll has been pared to some degree. The cumbersome overlay of bureaucratic structures has been partially reorganized and financial professionals are now playing an increasingly important role in the affairs of the city.

If this degree of progress has been made, one may legitimately ask,

why hasn't the market reopened to the city? I am afraid the answer lies in timing. Each of these steps, while laudable in and of itself, invariably came too late.

It is difficult to state precisely what actions would have reopened the market at any given point in time. But it must be clear to all that what would have reopened the market in April would no longer do the job in June; and what would have been adequate in June was insufficient in August. In short, throughout these long and enervating months, events and demands consistently outdistanced actions.

Another important point emerges from this troublesome history. There can be no doubt that Federal financial involvement at any point along the way would have stopped the reform process dead in its tracks. We need only look at what occurred when MAC was created in early June. For 6 weeks, virtually nothing in the way of reforms was accomplished. In late June, the need to obtain legislative approval of the city's budget caused a brief flurry of activity—announcements of layoffs, hospital and firehouse closings. But as the garbage piled up over the Fourth of July weekend, most layoffs were rescinded, and the closing orders have been largely ignored.

It was not until it became clear that MAC would be unable to borrow in August that the process of reform began anew. Each new deadline was faced with more strident demands for Federal assistance. And, after such assistance was again refused, the city and the State managed to take another hesitant, painful step in the right direction.

At the end of August, after nearly 6 months of crisis, the first meaningful data regarding the city's finances was released. While subsequent events have revealed that even such data was inaccurate and inadequate, at least a benchmark with which to measure the accomplishments of the past and the challenges of the future had been established. Again I ask the inevitable question: would such actions have taken place if Federal assistance had been promised or provided?

Much has been done, but much more needs to be done: A credible plan for the prompt elimination of the budget deficit must be implemented—I then go through a list of what needs to be done.

If these things are done, and the market does not reopen, is default the only solution? In recent weeks and again today, I have expressed the view that the financial risks presented by a default can be mitigated, and, objectively speaking, the impact need only be temporary and manageable. At the same time, I have been equally candid about our inability to measure the psychological impact. We have continued to make market assessments on an ongoing basis and we remain deeply concerned that dire predictions and vigorous rhetoric may compound whatever psychological risks do in fact exist.

The time has come, ladies and gentlemen, to concentrate all of our efforts to restoring our greatest city to fiscal integrity. I have said many times that fiscal integrity is easy to lose and hard to recover. As we proceed through this difficult period in our history, I can only hope that the travails of New York City will have some impact on our attitudes as to the proper role of government in our society. What New York City has learned in the past 7 months is a valuable lesson for us all. As we proceed with legislative consideration of the city's financial crisis, let us not ignore this important message.

The CHAIRMAN. Thank you very, very much, Mr. Secretary, for an extraordinarily able and thoughtful presentation.

[Complete statement follows:]

FOR RELEASE ON DELIVERY

STATEMENT OF THE HONORABLE WILLIAM E. SIMON  
SECRETARY OF THE TREASURY  
BEFORE THE SENATE COMMITTEE ON  
BANKING, HOUSING AND URBAN AFFAIRS  
THURSDAY, OCTOBER 9 AT 9:30 A.M. EDT

NEW YORK CITY'S FINANCIAL SITUATION

Mr. Chairman and Members of this Distinguished Committee:

Today marks an important juncture in Congressional consideration of the financial situation in New York City. Today we move from study, investigation and evaluation into the infinitely more demanding process of considering specific legislative responses. And as we make this transition, it becomes all the more important that the issues be dealt with in the serious and objective manner they deserve. Measured tones and deliberate analysis are imperatives. I have noted that there are two risks presented by a default: the financial and the psychological. I have often expressed the view that the financial risk can be mitigated. But at the same time, I have been equally candid about our inability to measure the psychological impact, and about our concerns that dire predictions and vigorous rhetoric may compound whatever psychological risks do in fact exist. It is our joint responsibility to see to it that these concerns are minimized.

The proponents of the legislation pending before this Committee believe that a major program of Federal financial assistance is warranted by the circumstances. I cannot agree. What is warranted, indeed required, is a comprehensive program of fiscal and financial reform in order to return New York City to the capital markets. There is a Federal role in this process, but it is not the role envisioned by the legislation before us.

Before turning to the program of reform, let me summarize for the Committee the current situation in New York City and New York State.

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First, as a consequence of the events of the past month, the credit of New York State and its agencies has--rightly or wrongly--become intertwined with that of New York City. The State's bond rating has been reduced and the rating on certain of its notes withdrawn. These actions are not based primarily on concern with the fundamental finances of the State. Instead, they reflect the realities of the marketplace: investors currently are unwilling to purchase New York securities in the present atmosphere.

Second, potential inadequacies in the financial structure of the New York State Housing Finance Agency have come to light. The financial community has acted most responsibly in analyzing the finances of this Agency and in presenting a proposal to the legislature designed to cure some of these difficulties. I believe it is important that this proposal be acted upon promptly.

#### Building a Bridge to the Capital Markets

All levels of government, and the private sector as well, share the responsibility for developing a workable program that will restore New York City's access, and that of the State as well, to the capital markets. What must be done is to build a solid bridge, span by span, over which New York City can return to the private capital markets. In my view, such a program should involve the following elements.

First, and foremost, New York City must adopt a credible balanced budget plan which provides for the prompt elimination of budget deficits.

The institutional framework is now in place, but the Emergency Financial Control Board and the new Deputy Mayor must now operate in concert, devoting all of their resources to implement the fiscal policies necessary to return the City to the market. Substantial additional expenditure cuts are required. Operating expenses must be eliminated from the capital budget. Employee benefit programs must be reviewed. And capital spending must be brought under control. These measures must be accompanied by a continued re-alignment of the City's management to insure that the tough decisions which have to be made will continue to be made. Until investors are convinced that New York City's management is in control of the City's financial future, there can be no market.

- Second, during the period of transition to balanced budget operations, the state should provide New York City with a temporary source of additional revenues, to avoid the accumulation of further deficits.

Such assistance should be provided by an emergency and temporary one or two year tax, perhaps an increase in the state sales tax. When New York City's budget has been restored to a sound fiscal basis, these funds can be repaid by the City over time through the state appropriation process.

- Third, the financial and investment community must also play an important role.

Irrespective of what conclusions one may reach about the potential impact of a larger financial crisis on our markets and financial institutions, there is no question that it is in the best interests of all concerned to avoid a potential problem. If the City and State take the actions outlined above, if operating and capital expenditures are drastically reduced, and if pervasive control is exercised over the fiscal and financial affairs of local governments and agencies within the State, then it will be in the financial community's own self-interest to help provide the requisite credit to protect investments made to date and to insure healthy markets in the future.

It may be that further commitments from the financial community and from investors may not be necessary. But if they are, certain actions may be appropriate.

Within the context of an orderly proceeding for the restructuring of New York City's debt, holders of short term securities may, if necessary, be asked to extend maturities for a short period--perhaps 2 to 4 years.

In addition, again only if necessary, the City's bondholders may be asked to agree to a moratorium on payments of interest and perhaps principal for a short period of time.

Once the threshold of budgetary control has been crossed, these actions can provide the bridge to return New York City to the capital markets. But any comprehensive program of reform must deal with longer range concerns as well. We in the Federal Government have a clear responsibility with respect to this part of the process.

- As a fourth part of the program, the Federal Government must accelerate a comprehensive review of Federal, state and local relationships. To put it bluntly, we must determine whether the priorities, practices and procedures of the past are consistent with the needs of the last quarter of the twentieth century.

Specifically, in the area of assistance to the disadvantaged, we should review once again our administrative machinery and make whatever changes are necessary to provide state and local governments the full benefits they are entitled to under existing law.

But a comprehensive response requires more action as well. If we determine that large cities and populous states are unfairly disadvantaged under existing formulae or programs, we should consider corrective legislation, if necessary, to remedy whatever imbalances exist.

I have often said that assisting the poor is a legitimate, indeed a fundamental, responsibility of a compassionate democratic society. But if we allow our assistance programs to lose the support of the majority of our citizens, our ability to provide assistance may be seriously impaired.

Fifth, we must propose structural improvements in the municipal bond market.

In proposing these changes, we will not have lost sight of the fact that even in these unsettled times the municipal market has served state and local government well.

During August alone, for example, four states and 225 municipalities raised nearly \$2.6 billion in long term debt. And contrary to widely held opinion, such funds were raised at a cost not disproportionate to historical levels.

Traditionally, yields on tax-exempt securities have been, on the average, 50 percent lower than taxable yields. Yield spreads will vary according to quality, maturity, call protection, monetary conditions and similar factors. Moreover, yields will also vary within rating categories. For example, largely because of the substantial volume of debt outstanding, yields on New York City securities were significant higher than yields on comparably rated securities of other issuers. It is noteworthy that in September, the spread between prime

municipals and comparable quality utility issuers was squarely on the 30 percent figure: That is 6.9 percent for municipals versus 9.9 percent for utilities.

While the market has performed well, improvements can be made. In recent years an imbalance between supply and demand has developed. Tax-exempt borrowing is at unprecedented levels: \$40 billion of bond and notes in the first eight months of this year alone. But the growth in demand--especially from institutions--has not kept pace. Casualty companies, always large buyers, have had their need for tax-exempt income reduced. And commercial banks, traditionally the largest purchasers of tax-exempts, have cut back their participation substantially, reflecting other sources of tax shelter such as loan losses, leasing activities, and foreign tax credits. In 1969, commercial banks were net purchasers of municipals in an amount equal to 97 percent of new issue volume. For the first six months of this year, their net purchases dropped to 12 percent of new issue volume.

In addition, also as a consequence of these specialized sources of demand, yields in the tax-exempt market tend to rise disproportionately during periods of tight money as banks are forced to commit their limited credit resources to their commercial customers.

Accordingly, to broaden the market, and to effect a reduction in the volume of tax-exempt debt, State and local government should be afforded the option of issuing debt on a taxable basis, with an appropriate interest subsidy from the Federal Government. Also, tax-exempt debt now issued for non-governmental purposes--pollution control and industrial development bonds--should be issued on a fully taxable basis, again with appropriate interest subsidies. According to our calculations, these changes should result in a substantial benefit to state and local government in the form of a broader market for their securities, which could result in lower borrowing costs, at little, if any, expense to the Federal Treasury.

- Lastly, partially in recognition of the growing participation of the smaller investor in the state and local bond market, we believe the time has come for a Federally imposed uniform system of financial accounting and reporting by state and local issuers which sell a substantial amount of securities in our capital markets.

Precipitated by major financial reversals such as the Penn Central bankruptcy, there has been a marked increase in the tendency of investors to restrict themselves to higher grade instruments--a "flight to quality" to use the terminology of the market. We must satisfy this legitimate interest of the investing public in detailed, accurate and comparable data by requiring complete and accurate disclosure. This system of disclosure has helped make our corporate markets the finest in the world. The time has come to broaden it to the municipal market as well.

In my view, it is these steps which Congress and the nation must focus upon in dealing with New York City's financial crisis:

- a sound fiscal policy administered by a realigned management, and including a credible balanced budget;
- a temporary increase in state assistance through a state tax;
- an orderly mechanism for debt restructuring, with the financial community and investors participating in the bridge back to the capital markets;
- a complete study on Federal, State and local relationships in the area of assistance to the disadvantaged;
- a broader market for municipal securities; and
- a uniform financial disclosure system for state and local government.

This is a program designed to attack the causes of the problem at their roots. But unlike the legislative proposals before us today, it is far more likely to return our greatest city--indeed all our cities--to a totally sound fiscal basis.

#### The Legislative Proposals

Three of the proposals before us today--S.1833, S.2372 and Senator Proxmire's suggestion of a taxable unsubsidized bond with a penalty premium--involve guarantees or insurance

of municipal debt. We are also considering Senator Bentsen's approach in S. 1862: Federal Financing Bank purchases of State and local debt. Finally, while not specifically on today's agenda, I shall also discuss Senator Humphrey's suggestion of a National Domestic Development Bank, embodied in S. 1473.

Generally speaking, my concerns with proposals for Federal financial assistance are twofold:

First, any such assistance would involve expansion of Federal credit, driving up Federal borrowing costs, the borrowing of all other issuers and crowding out certain marginal borrowers.

Second, the discipline of the market would be lost. No longer would spending be constrained by the desire to avoid higher borrowing costs or the loss of credit. Only pervasive Federal fiscal and financial control of local government, in violation of federalism, could provide the constraint.

#### Guarantees or Insurance

There is absolutely no difference between a guarantee program and insurance program. Either would involve a commitment by the Federal Government to meet debt service requirements in the event the issuer is unable or unwilling to make such payments out of its own revenue sources. And once provided, a guarantee could not be withdrawn if, for example, the issuer failed to meet the fiscal conditions of the program. The government's obligation under a guarantee program would be to the investor, not the issuer.

S. 2372 proposes that the Federal Government re-insure 75 percent of the risk underwritten by private insurers of municipal bonds. This proposal would be of no value to New York or any other city of even moderate size. The private insurance sector has been unwilling to commit substantial resources to this form of insurance and consequently the risk ceiling of the larger of the two private insurers is only \$20 million per issuer. Given that maximum risk level, even with Federal re-insurance only \$80 million of the securities of any issuer could benefit from the program.

#### Loans

S. 1862 and S. 1473 would in effect provide for Federal loans to State and local government. S. 1862 would use the existing mechanism of the Federal Financing Bank of purchase municipal securities. Since the purchases would be without recourse, there would be no means of enforcing compliance with

guidelines regarding fiscal restraint. I would also note that the \$5 billion purchase authority would be inadequate even to deal with New York City's needs alone.

S. 1473 would create a new bureaucracy--a National Domestic Development Bank--to allocate credit to State and local governments. Federal bureaucrats, located not only in Washington but scattered throughout the country, would be given the final word on whether a particular local need was worthy of financing.

Guarantees, insurance, loans, development banks--each of these proposals has serious implications for the condition of our capital markets, would eliminate market restraints on spending at the State and local level, and could threaten the traditional autonomy of these levels of government over their fiscal and financial affairs.

#### Impact on Capital Market

Too often, when we concern ourselves with the problems of the municipal bond market we tend to forget that this market is not entirely distinct, but is instead an integral part of our capital market structure as a whole. And the same things that are happening in our capital markets as a whole, the same things we warned about almost a year ago, are happening in the municipal market. Higher rates, shorter maturities, crowding out of sound, but marginal credits: these are the concerns the nation's mayors brought to the President and to the Joint Economic Committee two weeks ago. But they misplaced the blame. The blame primarily lies not with New York City, but with inflation, caused by massive continuing Federal deficits and the substantial new Federal borrowing required to finance them.

Any program of Federal assistance would further exacerbate these problems. Any expansion of Federal credit--including a federally guaranteed municipal bond--would further strain our overburdened capital markets. Federal borrowing costs would rise and, since our borrowing establishes a benchmark in the marketplace, the borrowing costs of all other issuers would rise as well. Many additional marginal credits--housing, small business, consumers--would be crowded out of the markets. Yield differentials between the stronger and the weaker credits, are at record highs: recently the spread between A and Baa Industrial bonds has been as high as 200 basis points; double the 1974 figures and four times greater than the 1971-73 average. Additional Federal credit in the market could cause these spreads to widen further. And if guaranteed bonds retained the tax-exempt feature, the impact on unguaranteed municipal issuers would be especially direct and could be severe.

Fiscal Restraint

Of even more concern is the potential effect of these programs on fiscal and financial decision-making at the State and local level. Like all borrowers, a State or local government's access to credit depends upon its ability to persuade potential lenders that its financial affairs are such that the lender can reasonably expect to be repaid. A Federal guarantee would have the effect of removing this element of concern on the part of the lender and thus have the corresponding effect of removing the market imposed restraints on the borrower.

The only effective substitute for the restraints of the marketplace would be direct Federal control. While some have suggested the interposition of State control, I seriously doubt whether it would provide a viable alternative. There would be little reason for a State agency not to yield to the same pressures as a local government in the absence of discipline from the market or some other source.

Federal control of fiscal and financial affairs at the local level presents grave practical and philosophical difficulties. This is not a dispute between liberals and conservatives, but rather simply a question of the right of citizens to be governed by their duly elected local leaders rather than by Federal bureaucrats.

We would have to create a new bureaucracy, simply to concoct and enforce the guidelines as to local priorities we here in Washington would be imposing on the Governments of the nation. We would be confronted with the sorry spectacle of duly-elected local officials lining up outside my door, attempting to persuade me that they were carrying out their responsibilities in a satisfactory fashion. We would, in short, be contravening constitutionally - imposed principles of Federalism; principles which lie at the heart of the structure of government in this nation.

Thousands, perhaps tens of thousands, of governments would resist this intrusion into local affairs. And they would be absolutely right. But in the final analysis,

theirs would be a Hobson's Choice: Submit to Federal control or pay the price of independence in the bond markets.

None of us can assess with any degree of precision the contribution the division of governmental authority called for by the Constitution has made to the quality of life in this country. But I doubt our society would be as heterogeneous, as tolerant of diversity, as responsive to local needs if all basic decisions were made here in Washington.

#### Comparison with Existing Programs

It is such considerations which plainly distinguish the pending bills from programs such as FDIC or FHA insurance. It is altogether appropriate to require that all of the nation's banks be subject to the same operating standards and be subject to consistent and detailed Federal supervision and regulation. It is equally appropriate that a citizen seeking the assistance of the Federal government in obtaining a mortgage disclose fully his financial situation and open the property he desires to purchase to extensive Federal scrutiny.

Imposing uniform standards on State and local governments is plainly an entirely different matter. Each political subdivision in this nation has unique needs. And each is led by a person selected for the job by an electorate which believed that such a person could best translate the needs of the community into effective governmental decisions. Yet any program of financial assistance would require bureaucrats in Washington to supervise these decisions and reverse them if necessary, irrespective of the wishes of the local electorate. It is one thing to supervise a corporate management, or to reject the views of boards of directors or stock-holders. Under our democratic system, it is quite another to supervise and control the affairs of local governments.

In short, State and local government have a special status in our Federal system. The proposals for Federal financial assistance now pending before this Committee would, of necessity, require that such special status be ended.

Guaranteed Bond with Penalty

As an alternative approach, the Chairman has suggested guaranteeing municipal debt, but imposing an extremely high interest rate penalty. First, as with any guarantee program, the adverse impact on the capital markets I outlined above would be fully present. Second, any conceivable penalty rate -- 3, 4, even 5 percent -- would represent a small increase in the burden on the borrower, relative to the value of obtaining access to credit. When an issuer is faced with the possibility of losing access to credit, it is likely to cut its expenditures, but when the prospect is only higher borrowing costs, the incentives for restraint are far weaker.

Impact of Default

I have concentrated today on a variety of approaches to the financial situation in New York City and New York State. I believe the approach I have suggested is desirable and workable. I cannot support the approaches in the legislation before this Committee. To complete the analysis, however, it is necessary to discuss the consequences if none of the approaches is adopted.

My views on the impact of a potential default have not changed materially. I have always believed that a default would be highly undesirable; "awful" may be the best description. I have always believed that a default could and should be avoided by any appropriate means. But putting aside for a moment the absolute desirability of avoiding default, I cannot conclude that a default would devastate our financial markets or our economy.

At the same time, I have often underscored the importance of psychological factors and our inability to predict psychological reactions with any certainty. We have been carefully monitoring the marketplace daily and have noted the developing psychological impact. Restraint is of utmost importance; I must point out that dire predictions of impending doom could well become self-fulfilling.

My views on the overall question of the impact of default are fully expressed in my testimony before the Joint Economic Committee and I do not need to repeat them in detail here. I do want to concentrate and expand upon one particular concern: the impact of a potential default on the ability of other State and local governments to raise necessary funds in the municipal market.

Earlier in my testimony, I noted that municipal governments are facing the same pressures as all other borrowers: a diminishing supply of capital at higher and higher rates caused primarily by inflation and the growing Federal usurpation of the supply of credit in this country. I also mentioned that within the municipal market itself there are structural problems which need to be addressed as State and local capital requirements grow faster than the demand for tax-exempt securities. I have also noted that all investors are increasingly sensitive to quality considerations and are demanding more and more evidence of financial soundness.

Perhaps the most important factor in today's market is uncertainty, a psychological factor which markets do not tolerate well. A number of intermediaries and investors are, we understand, refusing to commit funds to the market -- thus impairing the borrowing ability of many State and local governments -- until the New York City situation is resolved. New York City's difficulties have been the major factor in the uncertainty and have intensified investor concern with quality. But New York's financial crisis did not create the other problems besetting the market, and an end to that crisis will not make them go away.

Markets have a tendency to discount future events and a potential New York City default has been discounted to a significant degree in the form of higher overall yields and shifts in quality preferences. If default actually occurs, a possible further shift in quality preferences could influence the ability of credits which are perceived to be weak to raise funds in the capital markets. By contrast, the stronger credits may well benefit as investors' preferences shift even further in the direction of the higher grade issues.

I do not believe a default would precipitate a series of defaults by other cities through the country. No other city

has had a cumulative deficit like New York City's and thus none must borrow simply to meet operating needs from year to year. To the extent other cities must borrow within a fiscal year to deal with seasonal cash flow variations, I cannot conclude that a default will materially impair their ability to do so. In short, either other cities have the money to pay their debts or they do not. Those which do should be able to obtain credit.

In asking ourselves what the impact of a default would be, we must also ask the correlary question of what would be the impact of various mechanisms to avoid default. If, for example, New York City were able to avoid default by implementation of the plan discussed at the beginning of my testimony, I believe that the result would be a renewed sense of faith in the ability of the State and local government sector and our financial institutions to deal with even the most severe problems in a responsible manner.

If, on the other hand, default were to be avoided by a Federal assistance program, the reaction could be more complex. Clearly, there would be no basis for concluding that avoidance of default meant that State and local governments were able to carry out their financial obligations. Just the contrary would be true. Meanwhile, there would be far more incentive for State and local governments to embark on more spending programs, irrespective of whether resources were available to finance them. The discipline built into the present system would be lost entirely.

And even if the assistance program were limited to New York City, its impact would be felt throughout the country. Issuers and investors would come to believe that every municipal security -- or certainly those of major borrowers -- in effect carried the moral obligation of the United States, even without a guarantee in advance. What the Federal government would do for New York, all would believe, it would necessarily do for any other jurisdiction which became unable to meet its obligations.

But perceptive investors would recognize the fundamental change in our system of finance and would see the risks presented. The inflationary expectations generated by the

actual and potential expansion of the Federal credit involved would serve to accelerate some of the adverse trends we have seen in the markets over the recent past. Investors would become even more wary of long term commitments and would demand even higher yields on the commitments which are made. The ability of all sectors of the economy to finance investments in our future growth could be further impaired.

This committee faces some difficult choices. The risks of a default, in the final analysis, are unknown and unknowable. My own judgment is that such risks should be manageable. Moreover, as I have indicated in my testimony today, the proposals pending before the Committee presents a series of concerns which outweigh the risks as I perceive them. I would urge the Committee to concentrate its resources and its influence on approaches to the problem which will restore confidence in the fiscal and political integrity of the State and local governmental sector.

Mr. Chairman, I would like to conclude my remarks today with some purely personal observations. It has been nearly seven months to the day that the City's bankers reached the conclusion that a market no longer existed for the securities of the City. For this entire period, the citizens of the greatest city in the world -- its financial, industrial and cultural hub -- have lived from crisis to crisis. As one with deep personal and professional ties to New York City, I have great compassion for the plight of the citizens of New York and I share their determination to achieve a prompt and proper end to the crisis.

Over this period much in the way of laudable progress has been made. An "untouchable" expenditure increase for fiscal year 1975-76 was pared somewhat. The inexorable growth in the municipal payroll has been pared to some degree. The cumbersome overlay of bureaucratic structures has been partially reorganized and financial professionals are now playing an increasingly important role in the affairs of the City.

If this degree of progress has been made, one may legitimately ask, why hasn't the market reopened to the City?

I am afraid the answer lies in timing. Each of these steps, while laudable in and of itself, invariably came too late.

It is difficult to state precisely what actions would have reopened the market at any given point in time. But it must be clear to all that what would have reopened the market in April would no longer do the job in June. And what would have been adequate in June was insufficient in August. In short, throughout these long and enervating months, events and demands consistently outdistanced actions.

Another important point emerges from this troublesome history. There can be no doubt that Federal financial involvement at any point along the way would have stopped the reform process dead in its tracks. We need only look at what occurred when MAC was created in early June. For six weeks, virtually nothing in the way of reforms was accomplished. In late June, the need to obtain legislative approval of the City's budget caused a brief flurry of activity -- announcements of lay-offs, hospital and fire house closings. But as the garbage piled up over the Fourth of July weekend, most lay-offs were rescinded; and the closing orders have been largely ignored.

It was not until it became clear that MAC would be unable to borrow in August that the process of reform began anew. Each new deadline was faced with more strident demands for Federal assistance. And, after such assistance was again refused, the City and the State managed to take another hesitant, painful step in the right direction.

At the end of August, after nearly six months of crisis, the first meaningful data regarding the city's finances was released. While subsequent events have revealed that even such data was inaccurate and inadequate, at least a benchmark with which to measure the accomplishments of the past and the challenges of the future had been established. Again I ask the inevitable question: would such actions have taken place if Federal assistance had been promised or provided? Much has been done, but much more needs to be done:

- A credible plan for the prompt elimination of the budget deficit must be implemented;

- in that regard, the State must act to provide a temporary supplement to the City's existing revenue base;
- ineligibles must be removed from the City's public assistance rolls;
- capital expenditures must be reduced severely and operating expenses must be fully eliminated from the capital budget;
- the city's accounts must be fully conformed to acceptable accounting principles;
- reform of the City's management structure must be completed;
- if necessary, steps must be taken to restructure the City's short term debt.

If these things are done, and the market does not reopen, is default the only solution? In recent weeks and again today, I have expressed the view that the financial risks presented by a default can be mitigated, and, objectively speaking, the impact need only be temporary and manageable. At the same time, I have been equally candid about our inability to measure the psychological impact. We have continued to make market assessments on an ongoing basis and we remain deeply concerned that dire predictions and vigorous rhetoric may compound whatever psychological risks do in fact exist.

The time has come, ladies and gentlemen, to concentrate all of our efforts to restoring our greatest city to fiscal integrity. I have said many times that fiscal integrity is easy to lose and hard to recover. As we proceed through this difficult period in our history, I can only hope that the travails of New York City will have some impact on our attitudes as to the proper role of government in our society. What New York City has learned in the past seven months is a valuable lesson for us all. As we proceed with legislative consideration of the City's financial crisis, let us not ignore this important message.

The CHAIRMAN. Mr. Secretary, you indicated when you appeared before the Joint Economic Committee a couple weeks ago that it was within the power of New York City to avoid default. Do you still share that view? Do you still have that same opinion?

Secretary SIMON. I believe I said the city and the State, Mr. Chairman. This must be a combined effort.

The CHAIRMAN. I stand corrected. Do you still share that opinion, that the city and State together could avoid default?

Secretary SIMON. There again, we have gone on in this crisis for, as I said in my testimony, 7 months and New York City is still being denied access to the market. The uncertainty has also created a problem with New York State in its financing. Nobody can say with certainty that indeed it could be avoided if they did all of these following actions and if everyone—the bankers in New York City and New York State got together and devised plans.

My plan I'm sure could be added to and subtracted from and a credible plan put into place that could avoid default, but nobody is going to know, Mr. Chairman, until something happens and nothing has happened.

The CHAIRMAN. Well, a number of things have happened, as you pointed out on page 14, not enough in your view. You think more can happen, further reform. The question, however, is a tough, almost arithmetic question. As I understand it, New York has a rollover in the next 6 months that is obligations coming due which they have to refinance of \$2.8 billion. They have an operating deficit in the next 6 months of about \$800 million. They have capital needs in the next 6 months of \$1.5 billion.

Now I can understand that they could drastically cut those capital expenditures, although I'm sure there are some capital expenditures that may be absolutely essential; but that could certainly be sharply reduced; but how in the world is the city and this State, which has already jeopardized its credit severely and is having trouble selling its agency obligations—how can they come up with \$3.5 to \$4 billion under these circumstances? It just seems to me that any reforms that might be suggested would be wholly unrealistic. Is that wrong?

Secretary SIMON. Well, Mr. Chairman, it seems to me that—let's concentrate on New York State for a second—recognizing New York City is the largest and indeed the most important city probably, not only in New York State but many believe in the United States, I must admit from my parochial point of view I happen to think it's extremely important.

Senator TOWER. Next to Dallas and Houston.

Secretary SIMON. We could debate that point. But the point is, what's throwing a cloud over New York City is the recognition on the part of the investors that New York City must do all this financing. Until a credible financial plan is put forward so the investors say, "All right. They have a plan here and they know what they're going to do"—

The CHAIRMAN. Mr. Secretary, look what's already been done. The State has already created an agency that has taken virtual control of New York's fiscal operations.

Secretary SIMON. They have shuffled the debt around, as Arthur Burns said yesterday. They have transferred debt from the city to the State and—

The CHAIRMAN. But as I look at the list that you have, a shopping list beginning at the bottom of page 15 and continuing through the top of page 16, it's hard for me to see \$3.5 billion or \$2.5 billion or \$2 billion or \$1 billion. The only element that would seem to raise substantial funds, the only elements, are capital expenditures being reduced, and ineligibles being removed from the city's public assistance rolls, and I think you would agree that's not nearly enough cushion there to do the job.

Secretary SIMON. There's one other step Mr. Chairman, the possibility of New York State imposing a temporary tax increase for whatever period of time it takes for the New York City budget to get back in balance. You know, you get to the fundamental question we ask ourselves: Has New York State and New York City done enough so that the Federal Government must consider action? Have they done enough? And I'm suggesting no.

The CHAIRMAN. Well, I think you may be right and I think almost everybody here, including Senator Javits, would agree that something more can be done. However, I'm just wondering how we can be reasonable about this.

Yesterday the Chairman of the Federal Reserve Board suggested that the New York State impose a tax over a year that would cover half of the operating deficit or about \$500 million. Now in order to do what you propose here it seems to me they would have to impose a tax that within the next 6 months would bring in \$3 or \$4 billion which would be a tax of maybe 70 percent of their revenue during that 6-month period.

Secretary SIMON. You're talking about the total.

The CHAIRMAN. You suggested the tax.

Secretary SIMON. Yes, and what I'm suggesting is they have an operating deficit as we understand it in the area of \$800 million—a billion someone said, but these numbers have not been presented to the public yet. That is the estimate we have in the Treasury Department.

Now let's say that New York City puts forth a budget running through fiscal 1977 or fiscal 1978, and at the end of fiscal 1978 it shows a surplus; that they have begun to take the operating expenditures out of the capital budget and move them back to the operating budget; that they have implemented the tough cutback programs, whether it's tuition on the city universities or tolls on the bridges or whatever steps that New York City deems is proper at this point—a combination of all these, and admittedly they are tough actions, yes. New York State provides a temporary tax mechanism, perhaps through the sales tax—but I'm sure there are other methods—1, 2, or 3 years until the end of this program. Then, in my judgment, it is reasonable to expect that investors knowing exactly what the full story is, that there are financials, that the Emergency Control Board is going to run the affairs of New York City and insure that this program is carried out to the nth degree—

The CHAIRMAN. Then you expect the investors might react that way, but in view of what the investors have gone through over the last year, and particularly the last few months and especially the last 2 weeks, investors might very well not do this, and every expert that we have heard has indicated they think investors would not come up with the necessary funds.

Now supposing we can get this same reaction, this commitment by the State, commitment by the city, this firm assurance and write it into law, then the Federal guarantee would do the job. Then we would be able to provide the funds. Then you would get the discipline because the discipline could be enforced by the instrument that you provide, by the guarantee. In other words, the guarantee stops if they don't proceed to balance the budget, if they engage in any expenditures that aren't agreed upon.

Secretary SIMON. I think we're talking now, Mr. Chairman, about hypothesis because the actions haven't been taken—all the actions that could have been taken. Every action that's been taken—again, it's painful and difficult—they have been done begrudgingly because there's still the belief up there, I believe, that the Federal Government is going to do exactly—

The CHAIRMAN. I think they have to take more action and certainly whether I feel that way or not, from a realistic standpoint, New Yorkers realize the only way they're going to get Federal assistance is to take these painful actions and commit themselves to it and keep doing it; but my argument with you is that the immediate situation of requiring \$3.5 billion or \$4 billion, no matter what drastic action they take in borrowings over the next 6 months puts them in a position which will make it impossible for them to avoid default unless they get Federal assistance.

Now let me ask you this. If New York City defaults—we have just heard from Senator Humphrey and you heard his full statement. He said that the effects on New York would be absolutely catastrophic. You don't believe they would be. But in any event, it seems to me that they could be very, very serious indeed once they default. Then it would seem to me that the prospects of their being able to raise capital would enormously decrease and then Senator Humphrey's position—and I think it's a position that makes some sense—then the Federal Government would have to come in under very difficult circumstances. All municipalities in the country would suffer and at that point we have to move in with assistance.

Secretary SIMON. You know, you bring up a fundamental point about who gets paid first in this eventuality. Do the bondholders? Do the noteholders get paid interest on principal first, or are essential services allowed to continue? New York City, contrary to public belief, has had a greater revenue increase than most major cities in the United States each year. The problem is their expenditures have been double what their revenues have been. Their assessed valuations have continued to go up. New York City revenues in our analysis are nearly adequate—let's forget the bondholders and noteholders—to insure that essential services would be maintained in the event of a default. If need be, as I say, the restructuring that I outlined in my testimony for a brief period of time—3-, 6-, 9-month notes could be—

The CHAIRMAN. Mr. Secretary, how can you tell how brief a period of time that's likely to be?

Secretary SIMON. There again, a credible program to put the budget back into balance—

The CHAIRMAN. But the catastrophic effect of this city having defaulted is something, it would seem to me, to chill investors for a long

time to come. If I were head of a bank I would be very reluctant about buying obligations of the city that had gone into default and still faced these enormous difficulties, and certainly I would be very wary as an individual of investing in the bonds of the city under those circumstances, even with the high rate of interest.

Secretary SIMON. It would pay a penalty rate of interest.

The CHAIRMAN. Having defaulted?

Secretary SIMON. It always has.

The CHAIRMAN. Well, it would have to pay an extraordinary rate if it had gone through default. My point is, can we have it both ways? Maybe we can. Can we provide assistance to New York and still secure the discipline which you very properly call for and all of us recognize that New York must provide? They must cut the spending that they're going through. They must impose additional taxes. They must make a commitment to balance their budget. They must agree to permit the State to manage their operations and the Federal Government to have a veto over any action that might endanger our guarantee.

But I just wonder, under these circumstances, if it should not be the objective of the administration and the committee and the Congress to try to achieve an end which will get this reform and would also avoid the default that can very seriously affect the cities in every one of our States.

Secretary SIMON. As I said, Mr. Chairman, there is nothing that I would rather see than a default be avoided. I tried to tell my friends back in New York 7 or 8 months ago when they first came down that the Federal Government would take an adamant stand on New York State and New York City taking the tough steps that have to be taken. Sadly, lots of these things have not been done. The small steps have been taken. Much more needs to be done and we are not going to know the answer to your question until those steps indeed are taken.

The CHAIRMAN. Senator Tower?

Senator TOWER. Mr. Secretary, for the record, has the administration changed or deviated from its original position on the assistance to New York?

Secretary SIMON. No, sir.

Senator TOWER. There is no slippage toward perhaps getting involved?

Secretary SIMON. Mr. Tower, I don't know how my remarks last weekend which I repeated in my testimony this morning as to what steps New York City and New York State could take to avoid this problem, could be interpreted as a change in position. We have been accused of saying, "Well, we won't give assistance but there's nothing that can be done." So I thought it would be useful to describe one thing that could be done or a series of things that could be done, and I'm sure as I said before there could be others.

Senator TOWER. I was sure of that position, but I thought it should be stated for the record.

I understand that many States and cities have had no difficulties in borrowing as a result of the New York City crisis. Certainly, the financial affairs of my State and its cities are in good shape. Their bonds are rated high. It would appear that the ability to borrow without difficulty reflects the flight to quality that you have referred to. I think this is an example that a flight to quality is underway.

I have been noting some interesting figures, that seems to indicate rather severe discrepancies between fiscal practices in different cities. These are 1971 figures, and I don't have a complete update, but in 1971 the per capita outstanding debt of New York City was \$1,288 compared to the next highest city, Philadelphia, \$572, less than half that amount. New York's spending was at the rate of \$1,207 per capita compared to the next highest city, this time being Seattle, of \$446, almost three times more. The 1971 expenditures of New York City were greater than the combined expenditures of the next 24 largest cities comprising 23 million people, compared to 8 million people in New York.

That would indicate to me that some rather severe discrepancies exist between New York and other major cities.

Looking at other figures, Fortune magazine says that New York City has 51 employees for every 1,000 inhabitants. Most other large cities the ratio is 35 per 1,000. The current spending per capita is at \$1,224 compared to the average for all other cities in the country of \$295.

Of course, I think we all know that New York is in the grip of the trade unions. We know that wages are inordinately high there and they are ordinarily dictated by the trade unions without regard to demand for productivity or the burden on the city or anything like that.

One thing that I would like for you to comment on, Mr. Secretary, is it possible to show that the proliferation of matching programs by the Federal Government through categorical grants and the like have tended to encourage or provide an incentive for some cities to engage in programs and spending beyond the ability of their tax base to support it?

Secretary SIMON. Yes. I don't have an analysis with me on that subject.

Senator TOWER. In other words, I wonder if we're not part of the problem here.

Secretary SIMON. Well, of course, it does, and where there are matching programs they obviously want to take advantage of the Federal money that's available and they have to put their percentage up—25 to 50 percent of the money if they wish to build day care centers, as one example. So, sure, that adds to the problem.

Senator TOWER. Do you think that perhaps default on the part of New York City, perhaps a worsening of the problem, would ultimately force reform on the part of New York City so that it could act responsibly? Could it perhaps serve as an object lesson to other cities in the United States?

Secretary SIMON. I think that everything that's occurred thus far has already served adequate warning on other cities in the United States. Indeed I find no evidence of other cities or States which have this kind of a problem. I don't know of any other city that borrows in the marketplace to make up a deficit. Most short-term borrowing on the part of States and some larger municipalities comes in anticipation of taxes and is repaid when the taxes are collected. Nobody has had a cumulative deficit like New York City and nobody has got the unique problems that some people brought up here this morning like New York City. There are also the longer range problems that we have to look at—some of our formulas for Federal assistance and all the rest of our aid to our cities—is it up to date? Is it in the 20th century? But

I think the events thus far have served adequate warning on people to put their houses in order. What I fear, Senator Tower, is that if the Federal Government steps in at this point to guarantee or insure, does this remove that very strict and necessary discipline of the marketplace for many other cities in this country? Does it precipitate, regardless of what the punitive costs we might put on the borrowings, the demand for more Federal funds and more fiscal laxity than now exists?

Senator TOWER. There seems to be an awareness in the market that New York City is unique.

Secretary SIMON. Yes.

Senator TOWER. Of course, heavy pressure is being brought to bear on the Congress to establish legislatively some form of Federal assistance for New York City and it may very well come to pass. I haven't been convinced that we should do it myself, but my primary concern is the impact of New York's plight on the rest of the country and I think we have to view it in the national context.

Secretary SIMON. I agree with that.

Senator TOWER. If we so view it, and if we initiate some sort of assistance through legislative means, in your view what would be proper form for such assistance to take?

Secretary SIMON. Well, let me say at the outset that my judgment as Secretary of the Treasury as to what the proper form would be in no way implies that the President of the United States—

Senator TOWER. I understand that you would not necessarily support such a proposal, but what I'm asking for now is what would be the best way to go about it if indeed political pressures are brought to bear on us or we find that the impact on the country is adverse; then what would be the best way for us to proceed under those circumstances?

Secretary SIMON. Mr. Tower, if the Congress in its wisdom determines that the Federal financial assistance is essential in this effort, I would urge that it not create a new bureaucracy, an RFC type bureaucracy that always grows and cannot be gotten rid of to interpose itself into every facet of local affairs.

I would urge that Congress limit itself completely only to such measures, perhaps as Senator Proxmire has recommended, a narrow and restrictive program that would be administered by the Secretary of the Treasury.

I would further urge that any program prohibit assistance until the Secretary is satisfied beyond every reasonable doubt that the recipient is inexorably on the road to fiscal integrity and I would finally urge again, as Senator Proxmire has, that the financial terms of assistance be made so punitive, the overall experience be made so painful, that no city; no political subdivision would ever be tempted to go down the same road.

Senator TOWER. Thank you, Mr. Secretary.

The CHAIRMAN. Senator McIntyre?

Senator McINTYRE. Mr. Secretary, are you in effect saying to this committee that in your hard opinion that in the interest of good, constructive reform of the finances of New York City that the city ought to either swim or sink and you don't feel it will sink?

Secretary SIMON. I'm not saying that exactly because, again, the psychological impact, as I said, Senator McIntyre, is unknowable by anyone.

Senator McINTYRE. We don't want to take a chance on that.

Secretary SIMON. We can give a judgment. What I'm suggesting is that all of the steps and others that I didn't outline or different steps that would have a similar result, have not been tried and need to be tried before your question can be answered.

Senator McINTYRE. Let me ask you in terms of self-help, are there not State constitutional limitations on the city or State's ability to borrow in the short term, related to assured sources of revenue? Are they not up against a constitutional barrier?

Secretary SIMON. New York State could not without a referendum guarantee New York City debt, if that is your question. However, I believe—

Senator McINTYRE. Is there any legal barrier? One of your suggestions is to start taxing properly and to get enough income to pay their debts or—

Secretary SIMON. I believe that a special tax could be passed by the legislature to build this bridge that I talked about before with a repayment provision that I said out of future New York State appropriations which would provide the necessary capital.

Senator McINTYRE. Assuming some Federal relief is agreed upon, it seems to me there are at least two basic considerations. Do we not need to separate the problems of the State of New York and the problems of New York City and treat them somewhat differently? And how do we rationally do this, Mr. Secretary?

Secretary SIMON. Yes; that's true. New York City has to take the proper steps that one day it can indeed walk alone again and walk back to the capital market, but in the interim, you say, "All right, until New York City can do all these tough things, because that's going to take a little while to do, is it the State's responsibility to do everything that it can first, or should the Federal Government just step in first?" That is the question we're asking, Senator.

Senator McINTYRE. You heard Senator Humphrey. Do you believe that New York City is a peculiar city, a different city from any other city in this country?

Secretary SIMON. Yes. I would say that in a great many ways it is, due to the fact that it is the port of entry of so many people and it has so many peculiar characteristics; but again, some of its problems as far as its welfare programs are brought upon by themselves. I have a friend of mine—an acquaintance, who works in Newark, N.J., and has a very good job and he lives in New York City. I said, "My goodness, that's an unusual thing. Why don't you live in the suburbs?" He said, "Well, my wife was a government employee, and by living in New York City, she can collect large welfare payments, and so we're living over there instead."

Well, I suggest that all of these encouraging factors—the welfare program that's obviously rewarding—I will not repeat here for the record what I said to this chap, but you can imagine, Senator, but I would imagine that's going on quite a bit.

Senator McINTYRE. Do you agree with the Senator from Utah that says that New York's condition is probably due to the political ineptness of their leaders of the past 10 or 20 years?

Secretary SIMON. The last thing I'm going to do is point fingers at what went on before. I'm going to have a hard enough time going

back to work in that city as it is. Senator McIntyre, without commenting on what the problem was to start with. I do wish to return. We all know their problem. They spent a lot more money than they received for a long period of time, and finally the ultimate arbitrator said, "No more; the marketplace, and the disciplines of the marketplace, have been imposed. Then you ask the question, should New York State help them or should the Federal Government step in, and that is the problem Congress has to consider.

Senator McINTYRE. But nevertheless, it's been pointed out here that the problems of New York are not uncommon to them, that they are spreading throughout the country as we get into this business.

Secretary SIMON. Isn't that funny? I don't subscribe to that, and for the record, Senator McIntyre, I would like to put in not only Hubert Humphrey's city of Minneapolis but also it seems like about 35 or 40 States and municipalities, big and little—Philadelphias and Detroitis and all the rest of them—A's and AAA's, and show their net interest cost and what they paid and what the proportion was, and whenever it was out of proportion there was a good reason for its being out of proportion. It's having an unsettling effect. I agree with that, and it's going to have a further unsettling effect as long as the uncertainty remains, but it's not been demonstrated that these problems affect the other cities, no.

Senator McINTYRE. Would you say the same for the small towns and small cities throughout this great country? Are they having their troubles in the same type or way that New York City is?

Secretary SIMON. The small, well-run towns usually don't have the demands that the larger, medium sized and small medium sized do, and they are ordinarily and continue to be financed by the local banking systems because their name has never been nationally known. They don't have the liquidity that investors demand to enter the major marketplace, so they get financed by their local banking system.

Senator McINTYRE. So they are OK, as far as you know?

Secretary SIMON. Yes.

Senator McINTYRE. By and large, the small towns and cities of America are in good shape?

Secretary SIMON. We have no evidence to the contrary, although I'm sure, Senator McIntyre, that some do exist. There are exceptions to that statement.

Senator McINTYRE. One final question, Mr. Chairman.

It would seem that if the Federal relief is justified, it ought to be sufficient to restore confidence to the market without going any farther than a minimum temporary solution requires, yet this is a very iffy proposition because we never know how much that will take.

Now, Mr. Secretary, where do we draw the line so as not to jump way beyond where we ought to go if we do decide to bring some measure of relief to New York City?

Secretary SIMON. Well, I think I'd stand to my answer to Senator Tower, if Congress in its wisdom, and so forth, decided that some relief must be provided that program that I just outlined, with the very stringent criteria very similar to what the chairman has recommended—

Senator McINTYRE. Should it come after default in order that those bondholders lose their dough, or should it come before default?

Secretary SIMON. It's not a matter of bondholders losing their dough. You're more concerned with the impact—psychologic impact as far as our financial system and all of the other considerations that we have discussed, because it's been the experience and it was the experience back in the 1930's when cities did default that the bondholders were repaid. It was a moratorium on the interest payments. Some debt was rescheduled, but eventually the Michigans and others who defaulted at that time, the bondholders were paid. So they would be again. It would be a postponement of their payment.

Senator McINTYRE. In your opinion, Mr. Secretary, would the chairman's plan restore market confidence?

Secretary SIMON. Nobody can say with absolute certainty whether the plan that I outlined or the one the chairman has, which I'm not totally familiar with, would restore confidence, but the question is, it hasn't been tried and let's put a tough program in place and put that budget forward where people are going to say, "Yes, sir. They are going to be there 2 years from now. They are going to have a balanced budget. They are going to have  $\alpha$  tens of thousands excess. They are going to change their accounting procedures. New York State is going to help in the interim by doing this, the financial community of New York State." I'm not talking about the New York City banks. I'm talking about the Lincoln Rochesters and Securities Long Island, as well as the savings institutions, will assist in providing this bridge once the fiscal and financial credibility is restored; yes, Senator.

Senator McINTYRE. Thank you.

The CHAIRMAN. Senator Brooke.

Senator BROOKE. Thank you, Mr. Chairman.

And thank you, Mr. Secretary, for a very able and I think a very persuasive presentation.

I would be loathe personally to support any bill which would ensure the Federal Government in the local budgetmaking process except in the face of a grave threat to the national welfare. Senator Proxmire in questioning you asked what impact a default by New York City would have on New York. But I want to know what the impact would be on the Nation and on its economy. Could you give us some thinking as to what the impact would be on the national economy if New York defaulted?

Secretary SIMON. Well, in our judgment, Senator Brooke, it would not have—again, we are dealing with the financial side, not the psychological aspects of what would happen as far as individuals in the fear that has been created in some quarters as a result of the vigorousness of the debate up to date and many of the statements that have been made that I talked about off the cuff in my opening comments. It shows a lack of understanding of the marketplace of people who don't become experts in this subject. But if the essential services—we're making this assumption that the essential services of New York City are indeed maintained—there need be no disruption to the United States economy unless, of course, they were disrupted and the bondholders were paid out of the revenues. This has to be done in a very delicate way. It has to be handled in a scheduled way, yes, but it's our analysis that there would be insignificant impact as far as our economy is concerned. As far as the market consequences, Senator Brooke, I have talked about that here today and on other occasions at great length.

One can mitigate through the FDIC, through the Federal Reserve's role in providing secured liquidity to the commercial banks who may have overextended themselves as far as city paper is concerned, and that's not the major banks. That portion can be mitigated.

Again, what the psychological effect would be, no one can judge. We can just make judgments based on experiences in the past.

Senator BROOKE. Now, we're already beginning to hear from mayors of other cities who anticipate that they at some time may be in positions similar to that in which New York City finds itself. Do you know how many cities in this country now are close to the financial condition in which New York City finds itself?

Secretary SIMON. According to our analysis, none, Senator Brooke. We know of no city that borrows short term—and this is the important thing to understand—short term to finance a cumulative deficit as New York City has done. As these short term notes continue to be due, they have to pay them off, and in order to pay them off they have to do what we call rollover in the marketplace and if their credit rating has been impaired and their credit standing has been impaired as a result of a cumulative effect of borrowing like this, the market, as this one did, closes.

Now, I know of no other city that does this. The rest of the cities that finance short do so in anticipation mostly of tax receipts and then repay.

Senator BROOKE. Do you think that we are being subjected to a sort of scare tactic, that the country is being alarmed that if New York City goes into default then other cities are going to follow suit, and that our Nation's economy is going to suffer as a result?

Secretary SIMON. Well, again, I heard the mayors talk about the very high interest rates that they are paying and the fear when they are paying higher interest rates that the next step is not being able to borrow at all. The point is that everybody is paying higher interest rates. The prime corporations today have to pay 10 percent, rates that are more illustrative of a terminal stage of a boom than they are of a commencement of an economic recovery. Certainly municipalities are going to be paying higher than they did a couple years ago and this is occurring, but as I put in the record, these various cities, from Ector County, Tex., to you name it, all over the country are represented in the list of those who have financed over the last 4 months. It illustrates that cities big and small have been able to finance, some with distortions, because we take some A-rated securities in the municipal market. New York City has always traded substantially higher than other A-rated securities in the market, paid a higher interest rate, as a result of two factors. One, its veritable demand on the marketplace, 40 percent on short term notes, and the fear on the part of investors that they weren't running their business properly. These factors narrowed the number of investors that bought New York City's.

So you're going to have wide variations depending on how the investor perceives a municipality to be running its affairs. This is something that's really pretty brandnew and it started in the Penn Central, as I said, the flight to quality. Ten or fifteen years ago, nobody ever thought that the ad valorem general obligation tax of any general obligation security in this country could ever be questioned. Nobody got the proper financials. Nobody needed them. They were bought with the confidence that the taxing power of this municipality or State

backed the securities. This has put that whole notion under very severe question, to put it mildly, and now the investors are demanding to see more financial information about the State and municipalities. That's why we put in the mandatory reporting requirement. We think that's essential for States and municipalities to continue to finance at reasonable interest rates.

Senator BROOKE. Without oversimplification, it seems to me that we're talking about investor confidence. That's what we're trying to achieve.

Secretary SIMON. Yes, sir.

Senator BROOKE. That's what New York needs, is investor confidence. Senator Proxmire said that he felt in questioning you he indicated that if New York City did default, it would be difficult, if not impossible, to get investor confidence; the city couldn't come back. What's your opinion?

Secretary SIMON. Well, if I did imply that, Senator Brooke, I did not certainly intend to imply that.

Senator BROOKE. Not that you did. I think the Senator questioned you about that.

Secretary SIMON. Because again, this concerns the psychological impact. Is confidence going to be restored if New York City does all these things, if they restructure and they do everything we have discussed here this morning? Nobody knows with any certainty what the answer to that question is.

Senator BROOKE. But you don't have any fear of that?

Secretary SIMON. Well, certainly I am concerned about that. I'd be foolish if I were not. Of course, I am. My point is that what I have been asking, indeed imploring, for a long period of time is the right steps be taken. The President has asked Arthur Burns and I to monitor closely over these past 7 months the New York City situation and keep him posted on the events in the marketplace, most especially the psychology of the market, what the impact on the marketplace has been, and as each week and month has dragged by, certainly what could have been done in June wasn't acceptable in July and et cetera, right out to where we are now. So more is going to have to be done today than certainly would have had to have been done 3 or 4 months ago. I'm saying let's do what has to be done instead of just talking about it.

Senator BROOKE. One of the bills I think calls for 75 percent guarantee. Do you think that even with a 75 percent guarantee that the city of New York would be able to get investors for the remaining 25 percent?

Secretary SIMON. No, and, of course, the private insurance companies wouldn't pick up the slack for a couple of reasons. The first reason being you don't get fire insurance when your house is on fire, and the second reason is that they have a limit—the largest of the insurers has a limit of \$20 million per issuing and so that effectively would take care of any aid to New York City in particular.

It would have to be, whether it's a guarantee or an insurance or whatever the proposal is you're talking about—if there is to be involvement, you're talking about full Federal Government involvement, not partial.

Senator BROOKE. Thank you.

The CHAIRMAN. Senator Garn?

Senator GARN. Thank you, Mr. Chairman.

Mr. Secretary, I think Senator McIntyre's question is answered by the facts. I don't think you need to say you agree or disagree with my statement about the fiscally irresponsible leadership in New York City over a long period of time. Statistics read by Senator Tower I think show that. It's staggering. It's almost unbelievable that one city could spend more than the next 24 put together and most of the mayors of this country would agree with that statement and a long time before this came up.

And I do think, in answer to another question, I do think we are seeing a propaganda battle that overstates the effect on the rest of this Nation. Madison Avenue or whoever is doing it is doing a fantastic job of convincing the whole country that we are going to go down the river if New York defaults on their bonds. I think it's being greatly overplayed to put pressure on the Congress to come up with some kind of bailout program.

We have also had testimony here today and constantly heard that New York City isn't responsible for all these problems—the interest rates going up. Wouldn't it be fair to assume that the \$75 billion budget deficit passed by the Congress of the United States cumulative \$550 billion debt might have something to do with the economy of this country, that New York City isn't doing it all by itself?

Secretary SIMON. That, plus the extraordinary inflation that we still have; but most importantly, and I want to reemphasize this because when it's put in the record the spread between taxable and tax exempt issues, while there have been aberrations between various quality ranges, the spread can be generally said to be stable for tax exempt financing.

Senator GARN. I think we're seeing something perpetrated on us that can be a self-fulfilling prophecy. You mentioned inflation. When I was mayor, the number one cause of their financial problems is inflation. That's the only problem I had in balancing my budget when I was a mayor, the constant pressure of inflation, the cost of power going up by 9 or 10 times, the wage increases that ought to be considered in this factor, too. We can't say all the other sins are going to be spread on the other cities because of what happens in New York City. We are all suffering because of inflation. That's the number one budget problem in cities of this country.

Just to illustrate some of those cities—and I wonder how long I would have stayed mayor of Salt Lake City—to talk about 51 employees per 1,000 or 35. That's a big city, but you take the medium sized cities, Salt Lake City is about the 50th largest city in the country. We managed to have a very clean city that most people talked about and say, "My, it's clean and well kept, good police protection and so on." We had 13 employees per 1,000.

If you want to start multiplying this out, with no welfare included at all, just looking at personnel cuts, to do what New York City was doing and come up with that number of employees and pay the kind of wages and fringe benefits and all of those things, pensions—I would have had to instantly increase the budget by 900 percent and I wonder if the citizens of Salt Lake City would have liked a 900 percent increase in their expenditures in their city and the attendant tax increase that would have to go with it when they are already the highest taxed resident of the State of Utah.

I don't think we can ignore the causes of this problem and the fiscal irresponsibility that has gone on in New York City. I'm not sure the Feds are the ones to bail them out. As tough a shape as New York is in, I would suggest that maybe the fiscal irresponsibility of the Congress of the United States and the condition this country is in—I wish I could get some of my colleagues as stirred up about the fiscal condition of this country as they are of New York City. I would suggest, and maybe wonder if you would agree, the only difference between the financial problems of New York City and the U.S. Government are that we can print money and maybe that would be a simple solution to give New York a printing press and then they could go on building up the debt and they wouldn't default.

Secretary SIMON. I'd rather take ours away, Senator.

Senator GARN. I would agree with you completely, but I don't think we can separate the problems of New York City and the economic difficulties of this country and the unwillingness of public officials, whether it be in New York City or in the Congress, of not having the word "no" in their vocabulary. It seems to be forgotten.

As long as I'm on another tear, I might as well be blunt about it and say that I'm disappointed that some of my mayor friends, some who are sitting in the audience right here, are defending the kind of fiscal irresponsibility of New York City, but I guess the National Conference of Mayors is not any different than the American Bar Association or the Chamber of Commerce or national unions. They are self-protection societies and you wouldn't expect them to come in and testify and say, "No; I think New York City is irresponsible. We can't defend them." They always have to come in and give the testimony that you would expect from all the other groups. You never hear a doctor say an ill word of another doctor or an attorney of another attorney, and you're going to get the same thing from the leaders of the cities in this country.

Secretary SIMON. You'll never hear me say an ill word about my friends back in the investment banking business and you will be hearing from them and you have heard from them already. I respect their professionalism and I have talked enough about the uncertainties involved, but this notion that's developed over the last 15 or 20 years in the United States that every time anybody gets in trouble the Federal Government is the one who ought to aid and solve all the problems and just put money in it. Senator Proxmire, you have made some good statements on the floor of the Senate about that, about what the free enterprise system is about and two sides of that question—success and failure. If you remove the failure from it, we have destroyed our system. I suggest that before some of these people come down here and ask for Federal assistance that they think a little about the long-term trend of this country. I'm greatly concerned and I realize that I'm very unpopular as I sit here to say things like that, but I feel compelled to say them.

Senator GARN. I have nothing else, Mr. Chairman.

The CHAIRMAN. Senator Javits, you can question or testify. You have been so patient.

Senator JAVITS. I'd rather testify.

The CHAIRMAN. All right. Secretary Simon, thank you very, very much. You have been most responsive and helpful in your testimony.

STATEMENT OF JACOB K. JAVITS, U.S. SENATOR FROM THE STATE  
OF NEW YORK

Senator JAVITS. I realize the time is late with respect to lunch and I shall try to confine my statement to a very few minutes and then be open to questions.

Mr. Chairman, I ask unanimous consent that my total statement will be made a part of the record.

The CHAIRMAN. Without objection, the entire statement will be incorporated in full in the record.

Senator JAVITS. I will take just 10 minutes. I think I had better go ahead because time has just caught up with me as it has with you. But I will take 5 minutes and that will leave a few minutes for questions.

Mr. Chairman, I am not going to try to add to the bills which are before you, because you have got enough bills before you to write a good bill; I have no doubt about that. The only thing that my bill does that the others don't do is to include a title respecting an insurance facility, like the Securities Investor Protection Corp. for brokerage houses, which will insure holders of municipal securities up to \$50,000. Now whatever you may do about New York, I think that is a very sound idea that you ought to dig into, because it will encourage the breaking up of large holdings of municipal securities and get some of them into the hands of the rank and file of citizens.

None of these insurance schemes cost the Government any money and, as a matter of fact, they make money. So I would definitely consider that particular proposition. I included the provision among the things that I urge because I was very interested in self-help in the city of New York, having New Yorkers buy New York bonds themselves, and that was the reason for this particular provision.

Now there is no question about the fact that there's been great waste in New York and many, many very serious defaults in leadership, but the city has not been without character, either. It's suffered a subway strike. It suffered a sanitationman's strike which already resulted in the city being a very grave health hazard in order to try to resist the excess demands responsible. It is by no means just a rug to be walked over.

But the situation, Mr. Chairman, in New York is unique. It just happens that we have been the receptacle for a tremendous demographic migration in the United States with hundreds of thousands of rural poor from the South who moved to New York in the course of the civil rights revolution, and hundreds of thousands who came from Puerto Rico seeking economic opportunity because Puerto Rico is very much a part of the United States.

The result has been an enormous welfare undertaking of some \$600 million a year paid directly by the city from its own tax base. Most cities don't suffer from welfare costs at all, but we do because of the arrangements between the State and the city. And a 12-percent-plus unemployment rate makes New York practically a disaster area in that regard. In addition New York has roughly a million as a target population for bilingual education, which is a very, very expensive way to educate, and which we have some help from the Federal Government, but not remotely enough.

Then the deep problems of enormous sections of the city being

poor and unable to pay its way make necessary the humanitarian effort to render hospital services and educational services which could carry that enormous mass of people.

Now it's also been said, I think rather unfairly, that the city has not been doing anything in the last 7 months since it got into this terrible jam. That is not true, and I'd like to tick off for you what it's done.

A freeze has been placed on the wages of municipal employees and a hiring freeze instituted. Subway and bus fares have been raised from 35 to 50 cents—very tough in a time like this, very hard on the people—and bridge tolls from 50 cents to 75 cents in those bridges which are tolls; 31,211 city employees have been laid off since the beginning of the year and I ask unanimous consent to introduce into the record the official release on that subject which has just come out as recently as yesterday.

The CHAIRMAN. Without objection.  
[The information follows:]

REVENUE OR BORROWING REQUIREMENTS, JANUARY TO JUNE 1976, TO MEET NON-DEBT-SERVICE REQUIREMENTS

(Dollars in millions)

	Debt service (1)	Other expenditures (2)	Revenues (3)	Additional revenue or borrowing needed to meet non-debt-service requirements (4)
December 1975	\$486.9	\$978.9	\$586.4	\$392.5
January 1976	1,038.9	1,078.4	754.3	(324.1)
February 1976	490.3	982.2	867.5	801.6 (114.7)
March 1976	639.9	1,134.0	771.2	(362.8)
April 1976	164.5	1,075.2	1,090.6	(15.4)
May 1976	331.1	890.6	1,143.1	(252.5)
June 1976	367.4	975.7	1,538.7	(563.0)

<sup>1</sup> Items in parentheses reflect excess of revenues over "other expenditures."

Source: Office of Comptroller: Cash Forecast of Sept. 22, 1975.

NEWS FROM THE OFFICE OF MANAGEMENT AND BUDGET

[Wednesday, August 10, 1975]

Melvin N. Lechner, Director of the Office of Management and Budget, today said that payroll runs for September, 1975, show a sharp decrease of 9,408 full time employees from the previous month of August. This latest in a series of monthly reports on full time employees in New York City government lowers to 263,311 the total number on the payroll as of September 30, 1975—a decrease of 31,211 since December 31, 1974 or 10.5%

The most dramatic decreases during September were achieved by the Board of Education which showed 7,269 fewer people on the payroll than in the previous month—a result of the application of the economies directed by Mayor Beame.

There was a further decrease in Mayoral agencies from the previous month of 709. The Board of Higher Education reduced its payroll by 819, while Health and Hospitals Corporation achieved a reduction of 493 persons.

An analysis of payroll computer runs of full time employees for the period ending September 30, 1975, shows the following results:

	Dec. 31, 1974	Aug. 31, 1975	Sept. 30, 1975	August to September decrease	December to September decrease
Citywide	294,522	272,719	263,311	9,408	31,211
Mayoral	133,094	117,275	116,566	709	16,528
Nonmayoral	161,428	155,444	146,745	8,699	14,683

The payroll runs from which this information was developed cover only full time employees on the City payroll. They exclude CETA, EEA and WREP employees.

Included are the Off Track Betting Corporation, the Health and Hospitals Corporation, the Board of Education and the Board of Higher Education and only those employees in the Transit Authority and Cultural Institutions whose salaries are paid by the City.

Excluded are the Triborough Bridge and Tunnel Authority, the Housing Authority and the Transit Authority and Cultural Institutions except as otherwise noted.

Senator JAVITS. I continue with the cost of self-help efforts. In excess of \$2 million has been raised in the capital markets with the aid of the State agency, "Big MAC," a very very risky, but very patriotic effort on the part of the State of New York. There has been a rather complete shakeup in the financial management of the city, with outstanding businessmen like the president of the Metropolitan Life Insurance Co., Richard Shinn, and the president of the New York Telephone Co., Mr. Ellinghouse, having a direct relation to how the city runs its fiscal affairs.

Then what few people fail to take into account is that over \$300 million in area taxes has been advanced the city of New York by local taxpayers who are patriotic about what happens to the city.

Finally, and we have heard a lot about the quality of the so-called free tuition in the City University, the fact is that the City University's budget has been cut \$32 million, about equal to what paid tuition would be, and they have simply had to cut down and restrict their services rather than to go to a tuition plan, which would bar from the City University an enormous number of young people who merit higher education and who simply cannot pay the tab on any basis, even with the supplements and help of Federal and State Governments.

New York happens to have a very, very serious incubus of its own problem of poverty. And that is very tragic.

Now I will go right away, Mr. Chairman, to this proposition of whether we can make it or not until investor confidence is revived. It seems to me that this is strictly wishful thinking on the part of the administration. Because they don't want to do anything about this matter, that is what they start with. I think they are wrong, but that is where they start, and they have invented the doctrine of instant confidence. There is going to be no instant confidence, Mr. Chairman. It takes months and years to rebuild investor confidence, and New York's situation has become so bad that it has a shortfall in the next 4 months of over \$300 million, even if it stopped paying its debt service. Also, because of the timing of tax receipts, it's got to borrow \$1,194 million from December to the end of March, even though it will have a net surplus of \$83,900 for the months April-May-June, 1976.

So who is kidding whom? The fact is that services will stop. The fact is that you will have chaos and anarchy in New York, and you may touch off a depression in this country. It took one bank to touch off the depression of 1932, the Credit Anstalt in Austria. One bank, and here we face the failure of the most important and largest city in this country—in the world. Mr. President, we are asked to run that risk on the word of the Secretary of the Treasury, who say, "Forget it; it won't be a risk; investors' confidence will return." What are we

going to do if he is wrong? Nothing. We will do just nothing if he is wrong. He will probably continue to be Secretary of the Treasury, but the world will shudder and that is the risk we are being asked to run, for what?

Now the Secretary's main argument is teach New York a lesson, and that is the main argument of many others around here, teach New York a lesson. Well, whom are you teaching a lesson to? Eight million people who have consistently paid three and four and more times the Federal taxes to Washington than any other comparable unit pays in this country, for us to spend on farms and dams and many other projects upon which the United States lives; and the idea is being advanced that you are going to punish them and that, therefore, their reform is carried out in all this legislation. However, I would point out to the committee that every one of these bills calls for the most spartan position on the part of New York, including my own.

Now the answer, therefore, is this: Do you want to take the risk of New York going bust with chaos and the rest of the country and the world possibly being shaken?—I think they will be and very seriously—in order to punish New York, or do you want to punish them without running all those risks? You are going to punish them either way. You are going to punish them when you pass these bills. You are going to punish if you just stay your hand and do nothing.

I definitely believe—and I don't say this as any partisan New Yorker, but really as an objective U.S. Senator—that my State will take a heavy burden in this, under any circumstances, and I say that it is absolutely out of the question to run the risk we are being asked to run when the same discipline, the same spartan regime, the same things that you will do if you do nothing and run the risk, you will do if you pass the bill and don't run the risk.

The CHAIRMAN. Senator Javits, thank you very much for an extremely powerful and moving statement.

Senator JAVITS. I will come back if you want me to. I will happily submit to questions, if you want me to come back this afternoon.

The CHAIRMAN. If you'd like to come back about 2 o'clock, that will be fine.

[The complete statement follows:]

FROM THE OFFICE OF

# Senator Jacob K. Javits

New York

FOR IMMEDIATE RELEASE:  
Thursday, 9 October 1975

CONTACT: Peter Teeley  
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TESTIMONY BY. U.S. SENATOR JACOB K. JAVITS  
BEFORE THE SENATE BANKING COMMITTEE HEARING  
ON LEGISLATION TO AID NEW YORK CITY  
October 9, 1975

WASHINGTON -- "Mr. Chairman, I am pleased to appear before your Committee in support of legislation which I have introduced to establish a Federal Loan Guarantee facility for ailing local governments. In so doing, I would like to commend the Chairman for calling these hearings, and my colleagues who are appearing this morning with their own legislation. While the New York City issue was initially looked on as a local problem, and perhaps understandably so, it is clear by now that by any standard the New York City financial crisis is a national problem deserving of a national response.

My bill (S. 1833), together with its amendments, offers what I believe to be the best Federal response. Title I of my bill sets up an emergency loan guarantee facility similar in makeup to the loan guarantee operation we had for Lockheed. A Loan Guarantee Policy Board sets up general policies for the guarantee, and the day-to-day operations of the facility are managed by the Secretary of the Treasury. The maximum amount of any one guarantee which the Secretary can make in any one year is \$500 million under my bill, unless the Secretary submits a full and detailed report to Congress and neither House passes a resolution of disapproval within 30 days. The maximum total of all outstanding loans guaranteed under my bill could not exceed \$5 billion.

The loan guarantee facility is protected with several safeguards. For example, the Secretary would have to find that the loan is necessary to enable the local unit of government to re-enter the capital markets; that funds are not otherwise available on reasonable terms and conditions from any source; that there is a reasonable insurance repayment and that failure to provide the guarantee would seriously impair the ability of the local government to produce goods and services.

The guarantee would apply both to local governments (i.e. all governments below the state level) and to so-called "eligible corporations". I believe it essential to extend any Federal guarantee assistance to the obligations of municipal assistance-type corporations. One of my amendments, therefore, extends the loan guarantee facility to "eligible corporations", which are defined as any instrumentality formed under state law which has the authority to go into the market and use the proceeds of its borrowing to purchase debt obligations of local governments. To protect the loan guarantee facility from abuse, only such corporations as possess certain, rather far-reaching powers can be certified by the Secretary of the Treasury as eligible corporations.

For example, the majority of the members of the board of directors of such a corporation must be appointed by the Governor of the state, the Corporation must have wide audit and subpoena powers over the unit of local government, and it must be given authority to request and enforce financial management programs and to enforce limits on aggregate debt of the local government.

Title II of my bill sets up an insurance facility, again with the Secretary of the Treasury as administrator, which would hold individuals harmless for the first \$50,000 of loss from investment in tax exempt securities. One of the major purposes of this Title would be to encourage smaller investors to place funds in the tax exempt market, thus opening this rather constricted market to a hitherto untapped source. There is no reason, with New York and many other municipalities across the country paying in excess of 8 per cent, tax exempt, that the smaller investors should not be encouraged to buy up some of this paper.

A brief recapitulation of New York's chronology is helpful in understanding the present difficulties. Simply stated, New York City's current fiscal crisis is the end result of enormous borrowing by the City over the last ten years in order to meet the ever increasing needs of City residents. To put the matter in perspective, the following statistics are useful:

- \* New York City Mayor Robert F. Wagner's budget was \$3.8 billion in 1965;
- \* Mayor John Lindsay's budget was \$8.5 billion in 1972;
- \* Mayor Abraham D. Beame's budget is \$12.3 billion today.
- \* The annual cost to the City of debt service has gone from \$644 million in 1959 to \$1.8 billion today.

If I accomplish nothing else today, perhaps I can dispel the notion - advanced in some quarters - that New York City's problems are entirely attributable to its "wicked ways" or that they are a purely local issue.

I am the first to admit that there has been waste - on occasion extensive - and even accounting practices which amount to fiscal gimmickry, and I am also the first to agree that elimination of such abuses should be a prerequisite to Federal aid. But these evils are not the major cause of the crisis confronting New York City today. Rather, New York City's problems are primarily the result of attempting to cope with the enormous social problems of the day compounded by the recession and inflation which the U.S. has been experiencing. These problems include welfare, unemployment and skyrocketing costs of decent housing, education, medical care and senior citizen care. They are the very same kinds of problems which confront every city that attempts to grapple with human needs in our increasingly urbanized society; but in the case of New York City they are most pronounced because New York City has been forced to undertake a broader range of responsibilities than most other cities, including:

- 1) A \$1 billion welfare tab picked up by the City to assist needy persons, many of whom migrated to New York City from Southern states and Puerto Rico;
- 2) A 12 per cent + unemployment rate;
- 3) A bilingual education program with over a million target population and,
- 4) Hospital and university services offered free of charge in order to enable people to break out of the poverty cycle.

And all this has occurred during a time when the City's tax base has been shrinking, as industry and the middle class have moved to the suburbs. Also, we in New York met with a reduced tax base from the vast demographic movement of people to New York and the North and West, hundreds of thousands from the South in connection with the civil rights revolution of the 50's and 60's, and the relation of Puerto Rico to the United States.

The New York City crisis emerged last Fall (1974) when Comptroller Harrison Goldin began to challenge publicly Mayor Beame's projected budget deficit (Goldin said the deficit was \$650 million; Beame said it was \$430 million). This dispute was symptomatic of underlying economic disease. Soon thereafter (December 1974) the major New York City banks advised Mayor Beame that the market for City obligations was drying up (there is presently outstanding roughly \$13 billion in City notes and bonds) and this news was followed by the suspension in the Spring of 1975 of Standard and Poor's "A" rating on City debt obligations.

In hindsight, it seems that we failed to heed these relatively early warning signals and to take immediate steps necessary to restore "investor confidence". This was not the fault of any individual but the collective fault of everyone including elected officials, organized labor, private industry, the media and even the public.

But events - particularly the City's need to raise cash to meet debt maturities - overtook initial complacency and the following unprecedented austerity measures were implemented by the Mayor and/or the State Legislature in close cooperation with organized labor and the financial community:

- a) A freeze was placed on the wages of municipal employees and a hiring freeze was instituted.
- b) Subway and bus fares were raised from 35¢ to 50¢ and bridge tolls from 50¢ to 75¢.
- c) 11,211 City employees have been laid off since the beginning of the year, and tens of thousands of additional net layoffs are in the offing.
- d) In excess of \$2 billion was raised in the capital markets with the help of the State-created Municipal Assistance Corporation ("Big Mac"). Although many people fail to perceive the fact, big MAC bonds are not City obligations.

They are located by a special fund comprised of stock transfer tax and sales tax revenues which never go into City coffers but are diverted to meet Big MAC obligations. Big MAC's current chairman is John Whatum - an extremely able man from Lazard Freres, one of the nation's leading investment houses.

- e) In-depth studies of the City's management systems and expenditure control systems were undertaken by the Mayor's Management Advisory Board, headed by another outstanding leader from the private sector, Robert E. Fernal, President of the Metropolitan Life Insurance Company.
- f) In-depth studies of the State's long-term fiscal prospects and drafting of legislation for State takeover of courts and prisons and Federal takeover of welfare have been undertaken by the Temporary Commission on Finances. This Commission is headed by former New York State Supreme Court Justice Owen McGivern.
- g) Over \$300 million in real estate taxes have been paid to the City by State-based corporations on a voluntary basis and in advance of such obligations falling due.
- h) Some City operations (e.g. the Department of Commerce) and functions have been off-budget and other agencies have been combined in an effort to streamline operations.
- i) The City's public schools have been cut by an additional \$32 million, the amount of what tuition would raise.

During this period the State acts, and continues to take decisive action. Advances of over \$1 billion have been made to the City by the State, and the State's credit placed on the line to the extent that its own credit rating has been seriously jeopardized.

In addition to the above measures and in response to the deepening crisis, an important alliance group has been formed by me with Senator Buckley and joined in a number of instances by Governor Carey, Mayor Beame, Comptroller Levitt, and Congressman Delaney, Chairman of the New York Congressional Delegation. This Committee, which is chaired by Osborn Elliott, Editor-in-Chief and Chairman of the Board of NEWSWEEK Magazine, represents a broad spectrum of New York City interests and is committed to taking whatever steps are possible to improve the City's financial situation and enable its workers to maintain some decent quality of life during a period of economic hardship. New Yorkers are proud of their City and its rich history, and the Citizens Committee for New York City is a manifestation of that pride. It has begun to serve as a rallying point for the millions of New Yorkers who want to help get through these difficult times.

In September of this year it became apparent that, despite this program of austerity, Big MAC was unable to return to the capital market for funds. The market had dried up. MAC securities had become tainted with New York City's problems. To resolve this, the New York State Legislature created the Emergency Financial Control Board (EFCB) and assigned it the enormous tasks of 1) controlling the City's budget, 2) funneling all City money into a special account, 3) approving all City spending and contracts, 4) compelling the City to revamp its budget by October 15th, stripped of all fiscal gimmicks, and 5) developing a plan to wipe out the City's deficit over 3 years. The Board is headed by William Ellinghaus of the New York Telephone Company and consists also of Governor Carey, State Comptroller Levitt, City Comptroller Goldin, Mayor Beame and Albert V. Casey and David L. Margolis, the latter two having come over from the private sector.

Along with the creation of the EFCB, the Legislature devised a plan to raise \$2.3 billion to tide the City over through December. Components of this fiscal plan include:

- \$750 million in New York State funds;
- \$725 million in pension fund monies (of retired State and City workers);
- \$800 million from private financial sources.

The complex plan, remarkable in scope, received an initial setback on September 29th when the State's highest court - the Court of Appeals - ruled that the Legislature could not compel the State Comptroller to invest pension fund monies. This setback was overcome, however, when Comptroller Levitt voluntarily agreed to purchase State full faith and credit obligations (not MAC bonds) and the State agreed to use the proceeds to purchase MAC obligations. (Attorney General Lefkowitz and MAC have appealed the Court of Appeals decision and re-argument is scheduled for October 14th.)

There are hitches, but I believe the stage has been set to carry the City through until the end of this calendar year.

While the aforementioned dramatic events were unfolding, it was also becoming quite clear that the fiscal woes facing New York City could not be confined to the five boroughs comprising New York City. Whether it is because New York City is the world's financial center as well as the nation's and the world's leading metropolis, or because New York City debt obligations are so widely held, or because all our economic lives are so interdependent - or for all these reasons - we cannot escape the facts that New York City's problems are all of our problems; and that the solution to these problems is the responsibility of all of us.

New York State in its effort to rescue the City has exposed itself to grave financial danger in the forms of higher interest rates for borrowing and a lowering of its credit rating. Similarly, as early as last May, the City of Detroit was forced to pay the rather extraordinary interest cost of 8.86% on a new bond issue. Only one underwriting group dared to make a bid on this issue, and the emerging New York City crisis was cited as a major cause for this situation. Also in May, bond specialists were quoted as saying that activity was almost at a standstill in the municipal bond market, a market that normally raises \$22 billion annually for State and local governments and that at least eight cities besides New York faced the threat of having their credit ratings suspended because of cash flow problems.

A recent article in the WALL STREET JOURNAL quotes municipal bond experts to the effect that investors have held back substantially from all kinds of tax exempt obligations because of the New York situation. The article repeatedly points out that the impact is nationwide, and not just local. Cities such as St. Louis and Cleveland are already paying higher interest rates as a direct result of New York City. Cleveland taxpayers, in fact, are estimated to be in the red an additional \$450,000 because of increased interest charges directly attributable to the New York crisis. And, as recently as Tuesday of this week it was reported that officials of foreign countries (including West Germany, France and England) are quite fearful of the impact of a New York City default in their own capital markets. We cannot forget that the 1934 depression was touched off by one bank failure - the Credit Austalt in Austria.

"Spilling over" is not really accurate to describe the reverberations of New York City's difficulties in other markets. What is really happening is that New York City is experiencing the first shock wave of a financial catastrophe which, regrettably, is characteristic of our increasingly urbanized society during these times of inflation and recession.

One estimate of this increased cost of this catastrophe, applied to the amount of interest costs which state and local governments pay in interest on this debt, indicates that American taxpayers will be paying between two and three billion dollars per year in extra interest costs because of the uncertainty in the tax exempt markets.

The Federal issue is also clearly apparent, in terms of the health of the securities and financial markets generally. Some of the critics of aid to the city, for example, have pointed out that the ratio of the tax exempt to taxable securities yields - a typical measure of financial market stability - has remained at its traditional level of approximately 70 per cent during the entire time that the New York City crisis has been brewing. However, I must impress upon my colleagues that that situation has changed very dramatically in recent weeks, as was implied by Dr. Burns in his testimony before the Joint Economic Committee yesterday. The ratio as of the last week in September was in excess of 80 per cent, meaning that municipalities issuing tax exempt securities now must pay almost the same rate as prime rated corporations. Incidentally, I have been informed that the cities and states used for the purposes of compiling the municipal bond index do not include New York; what the ratio shows, therefore, is that other cities and States are so affected by the New York situation as to influence substantially the interest rates they pay.

What we in Congress face, therefore, is a set of competing risks. If we act, we run the possible risk that other units of government will start lining up at the Treasury for Federal assistance. I would not want this to happen, and I earnestly hope that such safeguards are written into any legislation as to prevent such an event from happening. We also run the risk, as Federal Reserve Chairman Arthur Burns pointed out yesterday, of putting some strain on our financial markets with the creation of a new series of Federally guaranteed debt. My answer to that problem is that the provision of essential municipal services is a very, very high priority, even compared with competing priorities in our financial markets.

On the other hand, the risks we face by inaction are in my mind far greater. We already have some indication of what is around the corner: spiraling interest rates for States and municipalities across the country, a virtually complete investor disaffection with all kinds of tax exempt obligations, the closing of the credit markets to many deserving State and local borrowers, the shutting down of government construction projects all across the country, the injection of chaos -- however temporary -- to our financial markets, and a serious aborting of our fragile economic recovery. This is a risk not worth taking compared to doing what is needed to avert it.

The CHAIRMAN. The committee will stand in recess until 2 o'clock this afternoon.

[Whereupon, at 12:55 p.m., the hearing was recessed, to reconvene at 2 p.m. this same day.]

The CHAIRMAN. The committee will come to order.

Senator JAVITS, you and I had to leave for another vote on the floor. Your testimony was consequently interrupted.

Senator JAVITS. Mr. Chairman, I have completed my testimony-in-chief. I simply wanted to insert a figure by way of the correction of a figure I gave.

I understand that the city of New York is the source for \$16,600 million in Federal taxes every year. The testimony is here replete with references to the fact that it receives one-eighth of its budget by various Federal payments, transfers, et cetera, \$3.5 billion in round figures.

I shall submit, if the Chair will allow me, a comparison from other major cities and other major States if I may do that.

The CHAIRMAN. Yes, indeed. We would be glad to have that.

Senator JAVITS. I have faced here before the wrath of my own constituents when I voted measures that benefited very little in Federal taxes. I had no compunction whatsoever with that. The same can be said of many other Senators. I am sure.

I only raise that issue because we have not complained. In fact, we have cooperated in many, many other things which were necessary to save other parts of this Nation.

Now, our time has come.

I would like to restate, because I was quite impassioned, Mr. Chairman, but I feel this is the real issue: the real issue is that the Secretary of the Treasury or President and others say strip New York to the bone, adopt a spartan regime, expiate the sins of the past by bringing the budget to balance in 3 years and the investors will come back to you.

I call that the doctrine of instant confidence.

On the other hand, people like myself say impose as spartan a regime on New York City as any fair person would consider reasonable and require the State to support the city—which, legally speaking, is a creature of the State—to the maximum extent that will not simply seriously impair its own credit standing and its own financial situation: and then give it an opportunity by meeting those conditions to put itself back in shape so that investor confidence hopefully may return.

If it does not, we don't want the city to run the risk of going bankrupt and touching off a real depression in this country and perhaps the world.

They both come to the same thing.

On the one hand we are proposing measures to eliminate the risk of the earthquake effect which I personally think will occur.

On the other hand, we are taking that risk.

I see no honorable reason in policy why we should do nothing simply on the word of a few people, high in Government, even who are admittedly expert in finance, who say it won't happen.

I produce for the chairman the evidence of Chairman Burns himself whom both of us heard in this very seat say only yesterday, that he was shaken by the events of the last 2 weeks.

We are men of great experience, Mr. Chairman, around here.

We are often very surprised at how speedily events overtake opinions.

Perhaps as good an example of that as any is what happened in South Vietnam within a space of a few weeks.

So I say it is not necessary to take the risk, to teach New York a lesson. New York will be taught a lesson no matter what you do, no matter which of these bills you pass.

That is a lot more secure way to teach New York a lesson if that is the objective—I think it is analogous to punishing 8 million people because of the alleged sins of their rulers—but be that as you may, if you want to do that you can do it as effectively without running a risk to the whole country and to the whole system.

The instant confidence theory won't work because even courts in the absence of evidence will say there are some things of which a court will take judicial notice.

That is the common experience of men.

If you throw a ball up in the air, it will come down.

It is the common experience of men that you can't restore enough confidence that if you default on your debt service you can raise \$1 billion by the end of March.

So, Mr. Chairman, and I think Hubert Humphrey was present in saying let's spend as much as necessary to avoid the city from shattering, so that we don't have to spend more to pick up the pieces.

The Chairman, Senator Javits, I think all of us in the Senate, whether we agree with you, as many do or disagree, as a number do, recognize that you are a man of extraordinary intelligence. You are as intelligent a man and knowledgeable a man as has served in the Senate in my experience here.

You have served in the Senate for 19 years representing the State of New York.

You served before that as attorney general of the State of New York. You served before that as a Congressman from a district in the city of New York.

With that background, you know as much about what the Federal Government can and cannot do and should and should not do and what the city or State of New York can do as anybody alive.

With that in mind, can you tell us what would happen in your judgment if the city did not get Federal assistance, if it had defaulted and was not able to meet this tremendous demand for refinancing for meeting its capital budget and its operating budget?

Would it under those circumstances be necessary at that point for the Federal Government to assist, and, if not, how would New York City and the State solve their problems?

Senator JAVITS, Mr. Chairman, you are very kind to me. I deeply appreciate it.

I cannot look into a crystal ball, I can only join my prayers with yours and that of every other American that no such thing as could happen does happen.

But I must tell you that at least one of the results in my judgment would be a very drastic fall in securities markets.

I don't see how that could be avoided if we let our biggest city go bust. It indicates the United States has lost something itself in terms of its determination to hold together as a nation.

Second, I believe that it would be a very long time winning back people to municipal securities even though we expedited the pressure.

Third, you have the terrible complications of a default. On the ground of common prudence I support regulating our bankruptcy statute to bring up to date.

But I doubt such a new bankruptcy statute would be in place before the event of a possible New York City default.

And I don't believe that the present bankruptcy statute would help at all.

I don't think the city, even if it wanted to, could qualify.

Then you would have as an immediate aftermath in my judgment a multiplicity of suits in New York asserting liens, et cetera. Courts would be flooded. The comptroller could not see his way clear to make any payments except under the auspices of a court to pay policemen, firemen, and sanitation workers.

You could have a general strike. It is already being threatened on the ground that the current crisis is being used to break down the whole area of collective bargaining between the cities and its employees.

You would cause a material erosion of the New York tax base by a further exodus—it has already cost us almost half a million jobs in the last decade.

The wreckage I have described is enough.

If you put a stop on relief checks, what do you think will happen in the Bedford-Stuyvesant and Harlems and Brownsvilles and South Bronxes of New York?

Even if I am completely wrong and these things are not going to happen, why run the risk?

What is being asked of the Federal Government? To lend its credit for a rollover for what Secretary Simon defines as an absolutely safe situation.

He says even the present bond holders will get their money. It would take 2 to 4 years. What is that to the Federal Government?

With all the remedies that would be involved, yours, mine and Senator Humphrey's, this thing would be No. 1 credit if there is anything left to be No. 1 credit for.

This is the issue. That is the essential argument.

The CHAIRMAN. So it is likely—nothing, of course, is certain. But it is likely if the Federal Government provides a guarantee that there would be no cost to the Federal Government. There would be no additional cost to other municipalities from higher interest and therefore higher taxes.

On the other hand, if New York does default, the Federal Government would in all likelihood on the basis of the disaster situation you described, would have to step in at that point with massive appropriations, substantial spending, and with an adverse effect on many, many municipalities or affecting all municipalities across the country.

Senator JAVRS. My answer is resoundingly, yes. When you compare the risk, if New York can come back that fast, why run the risk?

That is what Secretary Simon says. But if he looked at the city's cash flow he would have to admit no matter what you did you would not restore investor confidence by December 1.

That is a month and a half away.

The CHAIRMAN. Finally, Senator Javits, it is, I think, the problem really is trying to persuade the administration to see just exactly what you have said now and also trying somehow to work out the kind of a situation that Senator Tower and Secretary Simon developed at the very end of their questioning.

Senator Tower said what kind of a situation should we as a Congress be looking at if we relied on the advice of the Treasury to put together something.

He won't support it now.

Maybe like other people, he may change.

He said something so punitive that no other city would ever apply again.

Senator JAVITS. That is Draconian. You don't even punish criminals that way.

The CHAIRMAN. Nevertheless, it seems to me I got a feeling from him for the first time that the administration was beginning possibly to think about something they had dismissed without any consideration before.

Senator JAVITS. Mr. Chairman, may I make a suggestion?

The CHAIRMAN. Yes.

Senator JAVITS. You were kind enough to say such nice things about me that I am emboldened to do it.

I think the most important thing Arthur Burns said yesterday was that in the last 2 weeks he began to worry. That is in essence what he said.

I think if this committee should on the basis of these hearings go ahead and begin to mark up a bill, by the time that bill is ready for the floor, which would be about a minimum of 2½ weeks, and gets to the floor, which would be a minimum of 3 weeks, taking us to the middle of November, I think Mr. Burns and Mr. Simon and everybody else will be worried enough to talk business.

But if we wait and ponder, we will be too late.

The CHAIRMAN. Senator Javits, thank you very much. That is excellent advice.

We will try to mark up the bill as soon as we can.

Senator JAVITS. Thank you.

The CHAIRMAN. Our final witness is Mr. Lennox L. Moak, director of finance, city of Philadelphia.

#### STATEMENT OF LENNOX L. MOAK, DIRECTOR OF FINANCE, CITY OF PHILADELPHIA, PA.

The CHAIRMAN. We are glad to have you here, Mr. Moak.

Mr. MOAK. Thank you very much.

I wish to address my remarks today to both a short-term problem and a much longer term problem. As a director of finance of a large city, we are indeed suffering at this time in the municipal market. The results of many pressures upon that market and that those pressures have brought us to the verge of no market. For example, on

July 22 of this year, I offered a \$60 million general obligation bond issue in Philadelphia for which I would normally receive three bids. I received only one bid because of the basic market conditions.

In September with an A rating, a very high grade water and sewer bond, much above its actual rating and its quality, we paid 8.99 percent interest.

The following day I opened negotiations with the syndicate concerning our next need for cash of \$75 million of anticipation notes. In each case when I talked to a member of that syndicate, I encountered a great skepticism as to whether or not it could be done at all.

This is a city which when the books were closed for last June 30 would show a bona fide cash balance of several millions of dollars in its consolidated operating fund statement.

It is a city which has operated for 4 years with no tax increase and actually a small tax decrease. This is the antithesis of some people's concepts of irresponsible operation of a municipal government. It is, however, a city which needs cash in the course of a year in substantial amounts. We need long-term cash to carry forward a \$200 million to \$300 million capital program. We need short-term cash for about 10 months in the year in anticipation of taxes received in the last 2 months, and we need \$7 million to pay interest on money that we have earned from the State and Federal Government which has not been paid to us in cash. We must depend on the capital market continuously to provide both short-term and long-term financing.

Increasingly, it seems that the confidence in municipal bonds has disappeared. My analysis of this indicates that this is due to several factors. The first is there is no universal accepted accounting procedure for State and local governments so that one does not know when he reads an accounting statement precisely what it really means.

Second, there are no broadly accepted set of opinions for disclosure of information concerning financial conditions, and in many cases, especially general obligations bond issues are sold with no disclosure whatever to potential purchasers. This is not true in the case of revenue bond issuers. Yet, even there, it depends on the combined interests of the parties concerned in the transaction.

Third, there is a growing concern over the importance and reliability of ratings of tax to municipal securities. The securities I'm attempting to negotiate at the moment have the highest rating for Moody's, and yet I am having considerable difficulty because the market, allowing with discounting for New York and other places, has discounted the quality of the rating assigned.

Fourth, the market is inundated with unnecessary amounts of securities unrelated to the basic operations of State and local government. We have huge amounts of industrial development debt. Tremendous amounts of pollution control debt which has been authorized and some of it issued. We have community facility bonds which benefit hospitals, nursing homes, institutions of higher learning, and the like. If we wish to support, and I think they could and should be supported more efficiently through direct tax credits or appropriations, rather than by use of tax exempt bonds, notes, and mortgages.

This list goes on through numerous other types of facilities. It seems to me that the basic market, especially in the East, has reached

a point where if we are to restore it, we must take a number of comprehensive actions which are industrywide although they would be invoked largely on a voluntary basis.

Congress has recently established the Municipal Securities Rule-making Board within the Securities and Exchange Commission. I have the pleasure of serving as a member of that Board. I believe that the concepts which were considered by the Congress—and in part at my own suggestion modified—in the course of adoption of that measure should be reexamined. It is time for the establishment of municipal securities commission for oversight of municipal bonds in the United States. The commission would establish standards for disclosure, for accounting, recommended improved standards for rating of bonds and administer programs which are authorized by the Congress for its administration.

I think the legislation which the Congress should now consider should limit the use of tax-free bonds and the taxable option bonds, if authorized, to conventional State and local functions. We cannot support everything that everyone wants to support through a so-called municipal bond. The Bond Buyer, says that in the first 9 months of this year we sold \$22 billion or \$23 billion of long-term municipal bonds, plus an accounted amount of short-term paper—sold either as notes or direct loans to the banks.

The market cannot absorb this much paper on any reasonable basis. We have to take some forthright steps to reduce the demands on the market.

Third, I think Congress should establish the taxable option municipal bond with a substantial interest payment by the Federal Government preferably with the direct passthrough mechanism to the investor in order that we can get maximum benefits from them. I personally have some doubts as to whether that particular option, if used as an option, would do much to improve the market. However, for certain sectors of the market, it could constitute an important element of relief.

The fourth step which I propose is that the Congress establish a municipal bond insurance and guarantee program and that this program would be optional. It would be limited to debt for conventional government operations and the amount of debt to be guaranteed or insured or both should be limited in something like \$100 per capita in a city which was performing all of the local governmental functions such as New York or as in the case of Philadelphia, \$100 per capita to be divided between the city and the school district. This limit, if set low enough, would provide a guaranteed base for important conventional governmental activities, and would help to dissuade some of the unwise use of such a guarantee that involved no such limit. The prerequisites to qualification for the insurance and guarantee program would be to comply with the accounting standards adopted by the commission, to comply with disclosure standards, to provide assurance that the debtor government will provide revenues sufficient to meet the debt service. Moreover, the issuer should deposit with the commission an amount equal to the maximum annual debt service requirement on outstanding guarantee debt.

This is a device used in the case of revenue debt in municipal bonds today and helps improve the quality of those bonds. The issuer would have to agree to accept assessments made by the commission from time

to time to reimburse us for any losses which may be incurred. In that connection, it may be necessary to impose some limitation on the amount of such assessments in order to encourage those State and local government that have great responsibility to accept the provisions of this section. In other words, they might think they had to pay too high a premium in due course.

All of this would be applicable only to new debt or new capital programs. Outstanding municipal debt would be administered in its conventional manner except in a case I outlined briefly below. Additional debt for conventional functions beyond that guarantee would still be issued by State and local governments without such guarantee or insurance on either a tax-free or a taxable bond option basis.

Additional debt for municipal enterprises and facilities should be stricken from the list of tax-free and taxable option financing in order to hold down the market to a level that can absorb the debt most important to most citizens in State and local government.

There is a need to provide for important reentry of the commercial banks who have largely withdrawn from the municipal market in order to have support.

In connection with the New York emergency, I urge that future conversation concerning this matter differentiate carefully between potential bankruptcy and potential default. Potential bankruptcy arises from the fact that a man's financial affairs or corporation's financial affairs are in such a difficult position that they need a basic reorganization. It may be they need the protection from the law for a period of time from harassment in order to accomplish a rational reorganization.

Potential technical default confronts every issuer at any time he has a temporary shortage of cash and has an obligation due that is affected. The city of Philadelphia has a debt service payment due in January of each year. We have an adverse cash flow the first 8 months of our fiscal year. We may have healthy receipts in the last 4 months. If we have no way of anticipating receipts of the final 4 months in meeting the debt service in January, we are a potential defaulter.

We can like practically any State or local government in the United States, with the exception of those who carry huge surpluses, be put in a position of a potential defaulter. We should differentiate between this kind of situation and one that involves long-term problems.

In order to meet the problems of these two, especially the problems of potential bankruptcy, it is my suggestion that the proposed Municipal Service Commission promptly be created and it be authorized to undertake a pattern of insurance for refunding notes in 3 years to meet the debt service of State and local government in 1975, 1976, and 1977. The plan should provide for reorganization during that period so that the government affected can have its financial affairs put back in a suitable condition.

One thing which, despite the conversations I have heard here today and in many other places about New York, that has not been brought out clearly, I believe, is that much of New York's problem is the nature of the debt planning, rather than the amount of the debt. Probably 40 percent of New York's debt at any given time is due within 24 months. No other government except the U.S. Government,

and I don't think even it is ever in that posture. This is a tremendous percentage of its total outstanding debt being of short-term character. It has continued to place New York in a bad situation. If that were replaced by long-term debt, it could dispel the lack of confidence in the investors and would improve the situation in New York.

The remaining details of my proposal are in the memorandum I have presented to you. I will not burden you with recitation of those at this time.

Thank you very much.

[The complete statement follows:]

#### IMPROVING THE MUNICIPAL BOND MARKET: THE PRESENT SITUATION

(Substance of remarks of Lennox L. Moak<sup>1</sup> to the Senate Committee on Banking and Currency on October 9, 1975)

In many respects, the municipal bond market is on the verge of disappearance for many jurisdictions. Even where it is operative, exorbitant interest costs are required of issuers of medium and good grade bonds if they are to have any access to the market. These recent experiences of the City of Philadelphia suffice:

(1) On July 22, in a sale of \$60 million general obligation bonds of the City of Philadelphia, we received a single bid. Instead of three syndicates bidding vigorously against each other, as has been the custom in Philadelphia, all of the bidders were obliged to pool their resources in order to be able to handle a medium-sized, good grade general obligation bond.

(2) On September 29, the City sold \$50 million of very high grade water and sewer bonds of the City of Philadelphia at an 8.99 percent interest cost.

(3) On September 30, we made careful inquiry of a number of the leaders in the municipal bond field concerning the conditions under which Philadelphia could obtain a \$75 million bond anticipation loan. In each case we encountered skepticism as to whether it could be done at all.

#### REASONS FOR VIRTUAL DISAPPEARANCE OF MARKET

The reasons for the virtual disappearance of the municipal market are immediately tied to the New York situation; however, the fundamental causes go far beyond New York. It is to the latter conditions that I wish to direct your attention today:

(1) *There are no universally-accepted and universally-applied systems of accounting and reporting for local and state governments.*—There are three accepted ways of reporting revenues of these governments and also three ways of reporting expenditures: Cash; Full Accrual; and Partial Accrual.

This makes for nine distinctive ways in which a balance sheet and statement of financial condition can be developed.

Moreover, where municipal enterprises are involved, depreciation may or may not be used. This raises the number of alternatives to as many as 15 different ways in which the same basic facts can be reported—with 15 different answers as to what constitutes the financial condition of the enterprise.

(2) *There are no broadly accepted principles relating to what constitutes reasonable disclosure of information.*—In the issuance of general obligation bonds, it is customary that no official statement be issued.

<sup>1</sup>[This is a personal statement of Mr. Moak and does not necessarily reflect the views of the City of Philadelphia or any other organization with which he is associated.] Mr. Moak is Director of Finance of the City of Philadelphia and Senior Lecturer in Public Finance, Pels Institute, University of Pennsylvania. He is Vice-President of the Municipal Finance Officers Association of the United States and Canada. Mr. Moak is author of six volumes on different aspects of local government finance covering such areas as debt administration, sales tax enforcement, budgeting, capital programming and capital budgeting, and most recently a comprehensive volume entitled *Concepts and Practices in Local Government Finance*. Most of his professional work has been in research in state and local government. Prior to locating in Philadelphia in 1949, he served for 11 years in Louisiana, where he was on occasion Budget Officer for the State of Louisiana, Personnel Director for the City of New Orleans, and Lecturer in Government, Tulane University of Louisiana. He is a native of Mississippi and spent his youth and secured his education in Texas.

In the issuance of revenue bonds, the contents of the official statement depend largely upon the combined judgment of the issuing officer, the bond counsel, the consulting engineer, and, in negotiated deals, the head of the syndicate. But inasmuch as the actors vary from one bond issue to another, so do the contents of the official statements.

Even when the original disclosure is adequate, there are no requirements for an effective flow of continuing information during the life of the bond issue. Nor is there any uniform system for its organization and circulation. Nor is there any central point from which existing information can be secured.

(3) *There is a growing concern over the importance and reliability of the ratings attached to municipal securities.*—I am not undertaking to open up the basic subject of the matter of ratings and the manner in which they may be improved; however, any catalogue of the ills in the municipal bond market must not be ostrich in character.

There has to be a recognition of the importance of ratings and research into ways in which the systems may be improved.

(4) *The market is inundated with unnecessary amounts of securities unrelated to basic operations of state and local governments.*—There are many kinds of tax-exempt and tax-preference paper in the market which should not be there. Primary in this list are:

(a) Industrial development debt—whether in the form of industrial aid bonds, tax-exempt mortgages, or general development schemes of state and local governments.

(b) Pollution control bonds.

(c) Community facility bonds for the benefit of nonprofit corporations, e.g., hospitals, nursing homes, and institutions of higher learning.

(d) Housing bonds and redevelopment bonds in a wide variety of types.

(e) Commercial operations, e.g., office buildings, parking facilities, and stadia.

This debt is largely for the purpose of providing a subsidy to these different kinds of economic or social activities. The use of the municipal bond market as a means of providing such subsidy is both inappropriate and inefficient.

#### CORRECTIVE ACTIONS NEEDED TO REESTABLISH AND MAINTAIN A MUNICIPAL MARKET

In my opinion the Congress should enact a comprehensive plan which would include the following elements:

##### *I. Establish a Municipal Securities Commission*

The functions of the Commission would include:

A. General research in respect to and improvement of the municipal bond market.

B. Establishment of well-defined alternative systems of accounting which would be acceptable for application by state and local governments.

C. Establishment of standards for disclosure incident to the creation and servicing of debt of state and local governments.

D. Development of recommended improved standards for use of those who rate municipal bonds but, with the understanding that the rating agencies are not legally obliged to adopt such standards. The Commission would have no control in respect to rating agencies.

E. Administration of programs authorized by the Congress in support of the municipal bond market.

F. Absorption of any functions being exercised by other federal agencies that may be more appropriately placed with the Commission.

It is recommended that in the performance of functions "B" and "C", the Commission utilize the device of self-regulatory boards of the type that have functioned effectively in connection with the Securities and Exchange Commission.

##### *II. Limit the Use of Tax-Free and Taxable-Option Municipal Bonds to Conventional State and Local Functions*

The wide use of municipal bonds in the various ancillary areas (enumerated under No. 4 on Page 4) has contributed to the collapse of the municipal market. Congress should immediately withdraw the availability of tax-exempt securities for these purposes in the future. It should not extend proposed taxable-option bonds for these purposes.

Where the Congress believes that financial assistance is required for these areas, such assistance should be provided through either (a) tax credits, or (b) appropriations, or some combination of the two.

### *III. Establish a Taxable-Option Municipal Bond*

The advantages and the disadvantages of the "taxable-option" municipal bond have now been discussed for a sufficient period to enable a basic understanding of this proposal.

It is recommended that Congress establish such a taxable-option municipal bond on a basis of free choice of use by state and local governments.

For this taxable-option bond to perform satisfactorily, it is believed that the federal subsidy rate should be at least 40 percent.

The taxable-option bond would provide for significant improvement in the net costs of borrowing to many jurisdictions with good actual credit positions but which have been discriminated against unfairly in the marketplace through unwarranted identity with the problems of New York.

However, the taxable-option bond does not provide a basis for broad improvement in the bond market. However, if administered in a manner that assures a pass through of federal dollars to the investor, it could provide a modest support to the market circumstances.

### *IV. Establish a Federal Municipal Bond Insurance and Guarantee Program*

In my view, we cannot reestablish a market at reasonable costs to state and local governments short of providing a basic new set of conditions under which a large portion of municipal debt will be issued in the future.

After a very careful study of the matter for many years and intensified study during recent months, I am now of the opinion that the only way is to provide for a system of insurance and guarantees, on an optional basis, for those state and local governments which wish to take advantage of the system of insurance and guarantees outlined below.

The proposed Municipal Securities Commission would be responsible for the development and implementation of a system of insurance for bonds of state and local governments which accept this option in the issuance of that portion of their new debt which falls within the limits of the program.

The system of insurance and guarantees should be limited to :

(a) Debt for conventional governmental operations of state and local governments, including water and sewer systems but excluding other kinds of enterprise and ancillary operational debt.

(b) The amount of the debt to be insured or guaranteed would be limited to an amount determined through per capita and other techniques but would generally be limited to about \$100 per capita for each of the next three years. Within the three-year period, the Municipal Securities Commission and the Congress would determine the ground rules to apply to debt issued after January 1, 1979.

#### *Prerequisites for Qualification for Insurance/Guarantee Program*

To qualify for inclusion in the insurance and guarantee program, the issuing state or local government would be obliged to do the following :

1. Comply with the accounting standards adopted by the Commission from time to time.
2. Comply with the standards for disclosure at the time of issuance and during the period that insured and guaranteed debt is outstanding.
3. Provide assurance satisfactory to the Commission that the state or local government will provide revenues sufficient to meet the debt service on the debt at all times.
4. Deposit with the Commission an amount equal to the maximum annual debt service requirements on the outstanding guaranteed debt.<sup>2</sup>
5. Agree to accept assessments which may be made by the Commission from time to time in order to reimburse the Commission for any losses it has incurred as a result of default of obligation of a state or local government which is insured and guaranteed by the Commission.
6. Provide an equitable share of the operating expenses of the Commission.

The Commission would be authorized to insure all debt accepted by it and to pledge the full faith and credit of the United States as a further guarantee to such debt. It is intended that the guarantee will be solely for the purposes of increasing the acceptability of the debt in the marketplace and that the United States would never in fact be called upon to make good on the guarantee.

<sup>2</sup> Upon maturity of all the debt in an issue, the deposit and interest accumulated thereupon would be returned to the issuer.

The insured and guaranteed debt could be issued either as non-taxable debt or as taxable-option debt at the option of the issuer.

The effect of adoption of this proposal would bring down the rates of interest payable by those governments that accept the provisions of the Act. It would tend to standardize the risks and would thereby tend to provide only a narrow range of very high quality municipal debt.

#### *Outstanding Municipal Debt*

It is intended that the Commission should be primarily concerned with new issue debt. However, as outlined in a subsequent section of this presentation, the Commission would have important interim powers in relation to the reorganization of outstanding debt for state or local governments confronted with bankruptcy or default in its debt payments.

In all other respects it is intended that state and local governments work out their own problems in relation to their outstanding debt.

In this manner, the Congress and the federal government would be providing a vehicle by which orderly processes of capital program execution on a reasonable basis could go forward in all state and local governments.

#### *Additional Municipal Debt for Conventional Functions*

Beyond the insured and guaranteed municipal debt, state and local governments would be free to continue to issue their tax-free debt or their taxable-option debt to provide moneys in substitution for or as a supplement to the insured and guaranteed debt for *conventional* state and local government functions.

#### *Additional Municipal Debt for Enterprise and Ancillary Functions*

Except for completion of projects in the pipe-line, state and local governments would not in the future have the option of either tax-free or taxable-option debt in the financing or enterprises and ancillary purposes of the type that have been outlined on Page 4 of this proposal.

To the extent that state and local governments which to continue the operation of these functions or assistance in financing of these functions, they would be obliged to issue taxable debt in the name of the state or local government, or to provide subsidies to these functions within the requirements of state constitutional and statutory limits.

One final point. It is essential that the commercial banks be brought back to the municipal market and that they be encouraged to participate in it in a more orderly fashion than has characterized their participation during the past decade. This action is necessary; however, the means by which it can be accomplished is a topic for discussion at another time and after greater exploration of the options.

#### THE PRESENT NEW YORK EMERGENCY

In the discussion of the long-term program in the foregoing portion of this presentation, I have urged that state and local governments should be responsible for management of their own debt under the new system. This is, I believe, an essential element of any long-term survival of a federal system.

However, we are confronted with an emergency of major dimensions in the case of New York City. In order fully to understand the differences between New York and other cities (and perhaps some states) which could easily be severely affected by a New York failure, it is essential that we have a clear-headed distinction between two situations:

(1) *Potential Bankruptcy*.—When a corporation's financial affairs are in such a difficult condition that a thorough reorganization of these affairs is a prerequisite to its continuance as a viable organization and when such reorganization can be effected only under the protective wing of superior legal process that allows time and freedom from harassment, we must recognize that one is confronted with a *de facto temporary bankruptcy*.

This is the situation of New York City at this time.

(2) *Potential Default*.—A default consists of an impending temporary inability to meet obligations as they fall due. This can occur to corporations which are in basically sound financial condition but which are temporarily unable to secure orderly access to capital markets for *external* reasons that have little relationship to basic internal financial strength.

There has been an almost universal failure of those who have spoken on the current situation to make this distinction and to apply it properly to the financial affairs of local and state governments outside New York City.

There is a relationship between the potential bankruptcy of New York and the potential defaults elsewhere. However, it is a causitive relationship; it is not an organic relationship.

Temporary default by a large number of cities (and perhaps some states) can be triggered by a temporary bankruptcy in the case of the City of New York. These can, in my opinion, be avoided only if appropriate and timely means are applied to the New York situation in a vigorous manner now.

If a wholesale default occurs in New York City, the capital markets will become so disorganized that many other jurisdictions will not have orderly access to capital absolutely required for the *ordinary* management of their financial affairs. This lack of access can put these jurisdictions into temporary default. Such temporary defaults by a few jurisdictions can spread quickly to the point that almost no one has access to an organized capital market.

We cannot countenance this kind of catastrophe!

Not only the capital markets for state and local governments would be affected. The malaise would spread far beyond those precincts.

If we are to avoid this catastrophe, how can it be best done? My program is:

- (1) Immediately create the proposed Municipal Securities Commission.
- (2) Authorize a pattern of issuance of insured refunding notes with a life of up to three years to meet the debt service on any debt of a state or local government falling due within the remainder of 1975 or during 1976 and 1977.
- (3) Provide that the affairs of the governments which take advantage of this insured program be placed under the most rigorous supervision of the proposed Municipal Securities Commission. Where local governments are involved, the Commission could take advantage of state supervisory services, which would be an integral and required portion of the program.

Plans for the reorganization of the debt of each government taking advantage of the insured notes would be developed under guidelines established by the Commission. Legislation would be enacted which would enable the Commission to order such plans into effect and such orders would have the same force of law as the orders of a court in commercial bankruptcy proceedings.

(4) Provide the Commission with authority for insurance in an amount roughly equal to 125 percent of the total debt service requirements of the City of New York for the period November 1, 1975, to December 31, 1977. This should be sufficient to take care of New York City and such other governments as decide to take advantage of the emergency program.

I strongly advise that no emergency program be enacted without simultaneously enacting a program for a long-term reorganization of the municipal securities market along the lines hereinabove outlined. To do so is to delay the essential reorganization of that market in order that it can function effectively.

The CHAIRMAN. Thank you very, very much, Mr. Moak, for coming. This is most impressive. Your background, as I understand it, you are not only the Director of Finance for the city of Philadelphia, but you are lecturer on public finance at the University of Pennsylvania, and you are vice president of the Mutual Municipal Finance Officers Association of the United States and Canada.

On page 12, when you discuss the New York situation, you say temporary default by a large number of cities and perhaps some States can be triggered by a temporary bankruptcy in the case of the city of New York. These can, in my opinion, be avoided only if appropriate and timely means are applied to the New York situation in a vigorous manner now. By that, I take it that you mean that we have to provide some kind of assistance, loan, guarantee, something of the kind within the next very few weeks; is that correct?

Mr. MOAK. That is my belief. I know of a number of cities who are confronted with a tax pattern, revenue pattern similar to the one I have described for Philadelphia. If we cannot raise funds we—like the other places—will find that despite our basically sound position, we are out of business.

The CHAIRMAN. That is the kind of information this committee lacked this morning. A number of members indicated that New York

was *sui generis*. You point out it is unusual. It is the only city with the short-term problem. In spite of that other cities may be sound, but there are many cities that would have to go into default, too, because of the paralysis in the municipal bond market and the lack of confidence and the fact that banks and other investors would be unwilling to invest in the municipal bond market.

Mr. MOAK. That is my belief and my knowledge from a number of large cities in the Nation.

The CHAIRMAN. This is reminiscent—I'm not old enough to remember it as well as others and neither are you—of the run on the banks in the 1930's when, as I understand, banks that were sound would have depositors come in and insist on being repaid. Of course, even a sound bank could be put into a position of default under those circumstances very quickly. It required Federal action in that case to restore confidence, that's right.

Mr. MOAK. That is true. I happen to remember standing by observing one run on a bank in Port Arthur, Tex., in 1933, where money was carried out the front door of one bank to another bank down the street. Both banks survived and still survive today. But I have a recollection of seeing the panic associated with that action.

The CHAIRMAN. Your next paragraph is fascinating. You say:

If a wholesale default occurs in New York City, the capital markets will become so disorganized that many other jurisdictions will not have orderly access to capital absolutely required for the ordinary management of their financial affairs. This lack of access can put these jurisdictions into temporary default. Such temporary defaults by a few jurisdictions can spread quickly to the point that almost no one has access to an organized capital market.

What you are saying is if the default occurs in New York City on a wholesale basis, first you will have a few other cities that will not be able to borrow money and will be put in a position of not meeting their obligations after default. When that happens it is likely to spread so even the soundest city with the top rating and highest quality is in a position of very serious jeopardy and may well default also.

Mr. MOAK. This is brought on by the structure of a particular market that we are now in. Historically the municipal bond market depended on commercial banks for about half of the total new market offerings, upon the casualty insurance company for one-sixth and the remainder of the market for one-third to 40 percent. The commercial banks have largely withdrawn in the last 12 months for a variety of reasons. The casualty insurance companies have been obliged to withdraw because the adverse cash flows in that industry. This leaves us with the household sector. The household sector is composed largely in the municipal field of two groups. One supersophisticated in the form of the municipal bond funds. Numerically the greatest is the ordinary investor who has recently come into the municipal bond field. He is the man who can get scared the fastest as soon as one of his bonds defaults. He won't want any more and his friend won't want any more municipal bonds.

This is the kind of market that is most susceptible to the panic that you mention in the run on the banks.

The CHAIRMAN. That is very helpful. No witness has given us that information. This is most effective. You have a different solution here. Your overall program seems to me to be sound and thoughtful.

Obviously it would take some time to put that in effect. You say meanwhile in the case of New York, you could have to create at least a skeleton of the Municipal Securities Commission as you propose. Then you say authorize a pattern of issuance of insured refunding notes with a life of up to 3 years.

Now that approach goes beyond what you said in the body which would have limited this stringently to \$100 per capita which would be \$800 million for New York, far less than their requirement.

Mr. MOAK. I'm trying to distinguish between new issue debt and old debt that we have to reorganize.

The CHAIRMAN. That helps me. On old debt—you don't provide the tight discipline which other witnesses have suggested. That is that the city would show it has a good prospect of balancing its budget, show it has made a very strong effort, show that the State is behind it and all this. Do you regard that as unnecessary?

Mr. MOAK. I have participated in two modest rescues on a beach in my life. You don't stop in the midst of an emergency to make a lot of inquiries and get a lot of assurances. I don't have time to stop in the middle of this to make inquiries and get assurances. If we are going to keep this market open, you have indicated the crucial time which is now until Christmas. If we don't act before Christmas, it is my opinion that New York City will have defaulted and, having defaulted, the market will gradually close, if not close almost immediately. It has been almost closed 2 or 3 separate days in the course of the last few months.

The CHAIRMAN. That is a gloomy analysis for this reason: Whether we agree or disagree with you, we have to convince the administration to get a bill passed. We will not get a bill out of this committee unless we get consensus of the Republicans and Democrats. As you know, there is a strong feeling in the country that we should not assist New York. It is reflected particularly in the Congress. One price that New York people seem willing to pay is that they are willing to submit to these inquiries. They are willing to submit to whatever discipline may be required because they are desperate.

Mr. MOAK. Excuse me, sir. Perhaps you have not had opportunity to look at paragraph 3, that the insurance programs would be placed under the most rigorous supervision of this commission and where local governments are concerned, the commission could take advantage.

The CHAIRMAN. What it does not do is require any eligibility factor. You would permit a city to come in no matter what their setup was at the time, providing they agree to the discipline of the commission.

Mr. MOAK. Quite frankly, such knowledge as I have—and it is not complete—of the city of New York, no set of standards we would sit down and write as good abstract standards, could be met by the city of New York. Therefore, I don't see any point in going through the mental exercise—

The CHAIRMAN. I mean some of the things they have already done: reduce their spending, increase taxes, and so forth, so they reduce their deficit.

Mr. MOAK. I understand. My guess is you put what concerns the city of New York through the ringer. I was invited to New York and invited to be the chief of staff for the emergency board upon which the Governor and mayor sit. Therefore, I am not totally ignorant. In

my opinion, it would be very difficult for tests to be impartially administered that the city could pass.

The CHAIRMAN. Now, if New York—I want to be sure I understand everything you are saying. No. 1, you say that if we do not act, that it seems clear that New York will default before Christmas or after Christmas shortly?

Mr. MOAK. In my belief.

The CHAIRMAN. If New York defaults, then you are saying there will be other defaults and they will rapidly spread and we may have a situation in which no city is able to get financing?

Mr. MOAK. I don't want to go that strong. If my statement says no city, I have overstated my position. I'm trying to say the market would be vastly affected so many large jurisdictions would be out of the market totally.

The CHAIRMAN. When you say temporary defaults by few jurisdictions can spread quickly enough so that no one would have access to an orderly capital market.

Mr. MOAK. I don't think you will have an orderly capital market. It is not that everybody will default. In orderly capital market when I go to a market, I expect three bids. When I get one bid, I don't have an orderly capital market. I have a disorganized market where all bidders have come together and handed me one bid, take it or leave it. That is not orderly capital market. It is not to say there is no market. There is still a market but it is a very strange one and it is one which I, as an issuer, have to take or leave.

The CHAIRMAN. I'm glad we clarified that. You are saying that if New York defaults there will be other cities defaulting and most cities will be in a position that they won't be able to get bids from competing groups to sell their obligation. They will have to place it on the basis of having the buyer virtually dictate the terms.

Mr. MOAK. That is exactly what we have been confronted with already. We had to go to negotiated bids which we didn't want to because the other choice was take a single bid.

The CHAIRMAN. Secretary Simon indicated he thinks the air would rapidly clear once the situation is settled and the market has discounted the default by New York already. How long do you think the disorganization would last absent the kind of measure you proposed here?

Mr. MOAK. I stated that New York, on Sunday in speaking to the financial writers, that we would do very well 6 months after default, but during that 6-month period we would have varying degrees of chaos. I think 6 months after the major default the market would have reorganized itself to a considerable degree, so that many people who were temporarily out of the market would be in the market. During the interim period—

The CHAIRMAN. What do you base that judgment on? It seems that if New York defaults and bondholders go through the loss, that the municipal market would be scarred for years to come.

Mr. MOAK. I think it will be scarred for years; don't misunderstand. My judgment is within 6 months we will have a market. We may be paying a huge additional premium in order to have a market, but I think we will have a market just as we have some kind of market today.

The CHAIRMAN. Could you give us some notion or dimensions of the additional interest rate that might be a result of that kind of an experience?

Mr. MOAK. It is very difficult because we are now at the feather edge of a totally speculative market as far as municipals are concerned. If you consider a 10-percent municipal rate as equivalent to 20- or 22-percent taxable rate, anybody paying that 20 to 22 percent is in a speculative market. If you pay him 10 at tax-free rate, you are on the edge of a speculative market. Once you get into the speculative market, the ball jumps up and down like a yo-yo. It is no longer something you plot on a graph. It is like Big Mac bonds today jump around. Any bond in serious trouble jumps around.

I would say the figure would be in the range of 20 to 25, 30 percent above what we are now paying.

Mr. CHAIRMAN. In dollars, the municipal borrowings in this country are 200—

Mr. MOAK. \$25 billion per year. A new cost has to be associated with that rather than the \$200 billion mentioned here today.

The CHAIRMAN. What would be the cost of this? \$25 billion times 2 percent. Would you say it would be \$500 million cost?

Mr. MOAK. I would say we are talking about around \$1 billion per annum; \$1 billion per annum issue of additional cost.

The CHAIRMAN. Average bond is 10 or 15 years. The cost would be—runout cost would be \$10 billion.

Mr. MOAK. Over the life of the issue.

The CHAIRMAN. That has to be paid by property taxpayers all over the country.

Mr. MOAK. All kinds of State and local taxes. It is not all property taxpayers.

The CHAIRMAN. Not all property, but that is the one we are most sensitive to in my State.

Mr. MOAK. That would be the major source.

The CHAIRMAN. Thank you, Mr. Moak, very, very much. Yours was most helpful testimony. You have given us a lot of information we didn't have. I will call this to the attention of other members of the committee. I'm sure they will be greatly influenced by it. It is extremely interesting.

Mr. MOAK. Thank you very much.

The CHAIRMAN. The committee will stand in recess until 10 o'clock tomorrow morning, to reconvene in this room.

[Whereupon, at 3:10 p.m., the hearing was recessed, to reconvene at 10 a.m. Friday, October 10, 1975.]

[Material received for the record follows:]

STATEMENT OF W. M. ELLINGHAUS, PRESIDENT, NEW YORK TELEPHONE

My name is William Ellinghaus, president of New York Telephone, and member of the New York City Emergency Financial Control Board . . . and I'd like to thank this committee for inviting me to give my assessment of New York City's financial crisis.

It's my view that New York City desperately needs the help now of the Federal government because I doubt we're going to be able to make it on our own much longer. Despite our best efforts to put our City's finances in order . . . despite the financial assistance of the State of New York . . . the stringent reforms and reductions we are making in New York City's expenditures . . . the layoffs and the service reductions . . . the help from businesses which have pre-

paid taxes when they are still in the throes of a deep local economic depression . . . despite all this and more, we seem to be racing faster and faster toward default because the investor is afraid. Afraid now, not only of MAC securities, but of the entire national municipal securities market itself.

Default would do damage to more than New York City. The specter of default by itself is one of the most unsettling ingredients in our economy today. The real thing will be much worse. And that will be too bad because default can be averted. The action the City, the State and the Emergency Financial Control Board have been taking can put the City on a sound fiscal footing again. But to do it we must get out from under this cloud of default, which is creating so much uncertainty not only in the country but abroad. It is not for lack of trying ourselves that I appear here.

Back in April 1975, when the financial market became closed to New York City, Governor Carey and the New York State Legislature came to the City's assistance by creating the Municipal Assistance Corporation. MAC was given statutory power to borrow three billion dollars on behalf of New York City . . . with the purpose of enabling the City to meet its financial obligations until September, and then the City would be able to enter the money market on its own. When the MAC Board was formed, Mayor Beame asked me to serve as one of its directors, and subsequently I was asked by Governor Carey to serve as the Board's Chairman.

In July MAC put together a one-billion dollar bond issue. While that offering was successfully sold, we on the MAC Board were disappointed that there weren't more subscriptions to the issue and that it had very little acceptance outside New York City.

As we assembled a financial package for August, our difficulties increased. The buyer resistance we'd seen the financial community exhibit in July now had spread through other investment channels. MAC bonds, which are secured by tax revenues and which are not bonds of the city, were still considered by investors to be no different than New York City paper. Still, the August financial package was successfully sold, thanks to the cooperation of the banks in New York and organized municipal and State labor unions in the State.

By the end of August, however, the MAC Board got a clear signal from the underwriters that sale of a third billion dollars was impossible. There simply was no market for New York City or MAC securities in the amounts required to meet the city's immediate cash requirements. Accordingly, on August 25, the MAC Board advised the Governor that it could not raise the third billion dollars of its statutory mandate. We advised the Governor that the city of New York would be in default in September unless the Governor and the State intervened.

The Governor, as a result, convened a special legislative session the first week of September. The outcome of that session was passage of the Emergency Financial Control Act of the City of New York, which called for the setting up of the Emergency Financial Control Board. Governor Carey appointed me a member of that board, and I resigned as chairman and director of MAC.

The board's powers are spelled out unequivocally under the law.

The board, in conjunction with the city, is mandated to develop a financial plan for each of 3 fiscal years between now and June 30, 1978, when the city's expense budget must be in balance . . . and in conformance with the uniform system of accounts for municipalities.

The city's plan must provide for payment of its debt service, as well as for programs mandated by State and Federal law.

And the city in fiscal 1976 and 1977 must make substantial progress toward balancing the budget.

If those requirements aren't met, or if the city doesn't submit a plan approved by the board by October 20, 1975, then the board is required to formulate a plan of its own for the city that would go into effect October 30.

The board also can scrutinize any city operation and see that the city invokes what the board recommends to increase efficiency and improve services.

And, under the Control Act, city officials are subject to criminal and administrative penalties if they fail to carry out the board's directives.

Meanwhile, the city of New York has been acting.

It froze the wages of employees covered by collective bargaining agreements.

It put a freeze on the salaries of management and executive personnel.

It put a halt to all new capital construction projects.

It has cut the City University's budget by 32 million dollars.

Transit fares were increased.

City governmental jobs, since December 1974, have been reduced by a total of 31,211, through layoffs, retirements and attrition.

And the city has appointed a respected financial expert from business, who is working without salary, to serve as deputy mayor of finances.

In addition, there's also been help and cooperation from the municipal unions, which have invested in MAC bonds. Large companies, as I noted earlier, have prepaid taxes amounting to some \$330 million to ease the city's cash squeeze. The banks, despite large holdings in New York City obligations, have continued to help us find alternatives that would prevent the city from defaulting.

And finally there's been the support of the State of New York. Governor Carey, the legislature, the State's labor unions, Controller Arthur Levitt—all have been working to rescue the city.

The State has agreed to furnish some \$750 million. And now the State's own credit, which until recently had the highest rating, has begun to suffer.

New York State is finding it more expensive and harder to borrow in order to fund essential projects. The State of New York has done about all it can to help the city.

What this chronology of crisis adds up to is this: We have tried to go it alone. When we saw that the investor wanted more evidence that we were serious about living within the limits of our own resources, we created the mechanism to control expenditures and bring about improvements in governmental efficiency and productivity. And then we started cutting municipal services. But the money market remains closed.

Were the financial market open to MAC, we in New York City and the State would not be here asking your help. Because we now have the managerial and budgetary controls to put the city's finances on a sound footing by 1978. But MAC hasn't been able to borrow the rest of the needed funds under its mandate . . . and the city will not be able to go into the money market on its own in 1976.

We're making the sacrifices, all of us—the city worker, the subway rider, the banks, the taxpayers, the people of the State of New York. We can't go it alone.

The city's cash requirements must be met—and they won't be if the financial market stays shut to MAC and New York City. And that is why default looms. Not because we're not doing what's expected of us. The investment community, as I read it, believes we're serious about living within our means. But nonetheless, investors are afraid because default seems inevitable unless the Federal Government comes to the city's assistance. And, it seems to me, that fear of default could very well create default. It's as though we're back in the 1930's when it took Federal insurance to convince depositors that the money in their bank accounts was safe. I think it's going to take something like that to restore confidence in the municipal market today.

Default is a national and international concern.

Default by New York City would have colossal reverberations. It's time, I believe, for the Congress to act.

**RESEARCH INSTRUMENT COMPANY, INC.**

1975 OCT 11 12:05Z STEWART AVENUE, GARDEN CITY, N. Y. 11530 - (516) 248-1001

October 7, 1975

Senator Wm. Proxmier  
 Senate Banking Committee  
 United States Senate  
 Washington, D. C. 20510

Reference: New York City Financing

Dear Senator Proxmier:

I am writing the following so that it can be introduced into the official record and would appreciate its circulation to the other Members of the Committee.

The City of New York, everyone recognizes, is fiscally irresponsible. On top of it, we are seeing a game of Brinkmanship. We see the City administration not taking positive action immediately to stop the waste. The City is, by no means, bankrupt! If Chicago had a population similar to New York, based on their present number of employees, they would require about 100,000 employees to do what New York City requires 330,000 employees. It has been variously estimated that there are about 100,000 City employees who could be dispensed with without disturbing the basic, essential services. These 100,000 represent, primarily, political appointees who, of course, the present administration would not like to have to dispense with. Many practices that the City has followed has created, essentially, the highest paid City employees anywhere in the country plus the hidden, mountainous pension system. It has become the example for all other communities to follow as far as wage levels are concerned.

To cite one example of the City's administrators' "do nothing" attitude, for several years sanitation workers established their pension on the basis of the final overtime in the last years worked. The administrators arranged that those men who were going to retire had plenty of overtime so much so that when they retired most had sufficient income in their last years to give them 100% pensions. This was an out-and-out conspiracy to defraud the City. To the best of my knowledge and belief, the City has made no effort to set aside these pensions, which were obtained fraudulently, by the conspiracy of their fellow supervisors. Is this a City that should be helped? New York City can spend more money if they are allowed to. Little things, such as the Day Nursery Program, cost \$6,000.00 a year per child. This is far more than the economic benefit of the earnings

of the working mothers. Very few of the women, who can have gainful employment, can earn an amount equal to the cost of their children to the City. This is especially true where more than one child is involved. It is variously estimated that this program, alone, costs the order of \$200,000,000.00.

There are a few philosophical questions that must be answered. With all the monumental waste should New York City be helped or must the help come only after the waste is eliminated? Almost every Federal help program is politically contraverted when it is administered in New York City. The Brooke Amendment became a direct \$150,000,000.00 windfall to the recipients of welfare. We must rethink some of the social philosophies behind that which goes on in New York City. In New York City, the raising of illegitimate children is rewarded; the assumption being made that I, as a tax payer, must pay for the other fellow's bastard. Under the welfare system in New York, families have \$300.00 a month apartments, can operate an automobile and, even, have a color TV set.

The exodus of jobs from New York City is, partially, because in the low end jobs, you cannot find workers. Why work when the City provides all?

Enough about waste and philosophy - let us look at the market place for bonds. The problem in New York City is no different than the problem of anyone else trying to raise money in the present market place. Most utilities are, presently, strapped for funds in spite of huge rises in utility charges. There is insufficient money, for example, in the market place to finance the nuclear plants. Bond issues cannot be put out except with huge rates. An investor would be a fool to put his money into that which does not provide a high yield while inflation is what it is. Even good, old Uncle Sam is finding it has to pay 8.4% for intermediate term borrowings.

Part of the problem is that the United States is not generating sufficient new capital to finance the programs that already exist and, simultaneously, destroying the old capital; and when they decide not to print new dollars there just aren't enough bucks to go around.

Our great country has disintegrated into a country of political pressure groups and the politicians, unfortunately, do not have sufficient rectal fortitude to put the Nation ahead of the pressure groups who have helped elect them. The problems of the United States have been foretold as far back as the early 30's.

Many of the policies of the Government are, intrinsically, destroying the work ethic. It does not even pay to go to college any more.

We see the spectacle of Mayor Aliotto yielding to bombing and firemen becoming arsonists and vandal pressmen destroying the 1st Amendment and the Bill of Rights. Only a restoration of self control and a National interest can save the day. It is up to Congress to offer some kind of leadership which they are shunning.

The problem of New York is to demonstrate, now, that with the huge tax base that they are milking they can not only pay for all essential services; they must also squeeze the water out of the various jobs; such as Sanitation, 3 to 4 times the cost of removal of waste as in the private sector; \$15,000.00 a year change-clerks in the subway system; 1/4 million dollar pension benefits; public housing at \$50,000.00 per apartment. This clamor for aid from the Federal Government should be put in proper perspective. New York City must be saved from its politicians and administrators but the dilemma is, how can a Democratic Congress do this to a Democratic City with 100,000 political appointees.

Very truly yours,

RESEARCH INSTRUMENT COMPANY, INC.



Milton Stoll, President

MS:m1

Written Statement of James A. Lebenthal, Executive Vice President, Lebenthal & Co., Inc.

Consequences of New York City Default on Individual Bond Owner

Nobody claims to know who the owners of New York City's bonds are, and that is just one of the enormous difficulties in visualizing in human terms the consequences of default by the second largest borrower in our capital society.

The Municipal Bond firm of which I am Executive Vice President, Lebenthal & Co., Inc. with offices located at 1 State Street Plaza, New York, NY 10004, may be in a unique position to supply some hard statistics on the ownership of New York City bonds.

Since 1925, Lebenthal & Company has been specializing in Municipal Bonds, catering almost exclusively to the individual investor.

An analysis of the business records of our firm leads me to the estimate that no less than 160,000 small individual investors own the major portion of New York City's outstanding long term bonds. New York City has a total of \$7,350,610,000 bonds outstanding. I would place the combined ownings of these 160,000 households at approximately \$4,895,000,000, two thirds of the debt outstanding\*.

But because the tax free coupon interest from municipal bonds need not be reported and the Treasury Department has no record of municipal bond ownership... because the federal reserve figures are preoccupied with bank ownership and it is only through a process of elimination that we have any governmental figures at all on ownership by households of \$62.3 of the \$207 billion state and local debt outstanding...and because of the natural reticence of people to speak openly about their money, the impression could exist that Municipal Bonds are the private preserve of banks and a few Park Avenue millionaires.

That is not the picture I am now going to present or that is supported by the more than 300 letters Lebenthal & Co., Inc. has received in reply to a request for bondholders on our mailing list to come forward, write and be identified, a small sample of which are appended hereto.

The typical owner of New York City bonds is on in years.

The bonds represent the family's savings, accumulated over a lifetime.

Payment is usually made by check drawn on savings accounts. The bonds are savings.

The average transaction is \$10,000. The average portfolio is less than \$35,000.

The typical New York City bond customer at Lebenthal files a joint return on approximately \$25,000 a year, which is the 36% federal income tax bracket and a combined tax bracket in New York State of 45%. One did not have to be a tycoon to benefit meaningfully from the extraordinary tax-free yields that New York City issues have produced over the past five years. At the 80% tax-free to taxable yield ratio that

\*This analysis of the ownership of New York City debt by individuals is limited to funded debt, bonds only, of which Lebenthal & Co., Inc. had been a major underwriter and marketer. Not having been an underwriter of the city's notes, the company has played a negligible role in the marketing of notes and does not possess the expertise to analyze individual ownership.

has prevailed in the 21 issues that have come out during those years, the tax-free takehome pay from the New York City municipal bond would produce the following yield advantages for this many households in the U.S. over the after tax return from taxable alternatives:

25%	advantage for	2,370,000	households in	36%	or higher	federal	bracket
34%	"	"	1,520,000	"	"	39%	" " " "
38%	"	"	1,070,000	"	"	42%	" " " "
45%	"	"	790,000	"	"	45%	" " " "
54%	"	"	620,000	"	"	48%	" " " "
62%	"	"	510,000	"	"	50%	" " " "

The typical investor, buys any Municipal Bond to hold to maturity. Not to trade. Not to make money off market moves. But for income to live on, to provide for retirement or a fund for the future such as children's college education.

These excerpts from the letter appended hereto express the frugal nature of the typical individual municipal bond investor:

"My wife and I live in an old clapboard house in a rural town of 1,000 inhabitants in upstate New York. We both work, and we both drive Volkswagens. Our thermostat is set at 65 during the hours we are at home and awake, and 60 all other times. We burn wood when we want to be warmer...Our steaks are chuck, and infrequent. We have chosen our style of life, and I think we live well.

I am not a bank, and I am hardly a millionaire. The New York City bonds I own represent a considerable portion of my savings. I purchased the bonds because they provided an excellent tax-free return, and like others I thought them secure." William M. Burstein, RD 2, Petersburg NY 10138

"I, too, am one who put his own savings plus the savings of those who trusted my judgement into Municipal Bonds of N.Y.C. I understood the security of NYC Bonds was second to that of the U.S. Government. I never dreamed a city so great, so vital to the economy of the U.S. could or would be let to default." Robert J. Forrest, 378 Red Maple Drive, Wantagh, NY

"I am about to reach the age of 70 and was preparing my hard earned money as a house painter for a safe income. I own City and State Bonds which I considered a very safe investment, and as I understand now should N.Y.City default the bank will be protected, but I believe my money was earned much harder than the banks. I slaved all these years to earn this money to have a little protection for my old age." Mr. Max Hochberg, 23 Hickory Hill Dr., Dobbs Ferry, NY 10522

"My husband has a job that does not afford him a pension. He started buying municipal bonds in 1968, spacing the maturity dates so that we would always have some money coming in to live on.

There was no gamble involved when we purchased bonds. If we wanted to gamble, we'd have invested in the stock market." Phyllis Jacobs, 15-16 Prospect Ave., Fairlawn, NJ. 07410

"I thought I was making a conservative & sound investment when I took funds from my savings account to buy NYC bonds. My thoughts were to plan for my retirement five years hence." Irving Karess, 12 Baker Hill Road, Great Neck, NY 11023

"...I bought these bonds with the full faith of the city behind them. I did not seek great financial gains in the stock market or business investments. All I wanted was security and the ability to sleep well at night knowing that at a later time in life, I would have no financial worries..."

Daniel Klein, M.D.  
3689 Bedford Avenue,  
Brooklyn, NY 11229

"We are in the middle seventies and for security reasons at this stage in our lives we liquidated much of our investment in common stocks and transferred it to safe and sound municipal and state bonds..."

Ben Levin  
545 Central Ave.,  
Cedarhurst, NY 11516

"All my life I've worked. I've worked for Klein's Dept. in the great depression for \$2.00 on a Saturday. I've worked in factories. When I married, after I had my children my husband took sick and I worked for eighteen years... Every dime I saved went into New York City savings Bonds, now I am told that these Bonds are going to be worthless. I am heartsick. I have nothing to look forward to living any-longer...."

Mary Millstein  
35 P. Seacoast Terrace  
Brooklyn, NY 11235

"My wife and I are conservative Midwesterners who grew up in middle and lower middle class homes in southwestern Ohio. We both experienced the Depression in the 1930s in this area; and accordingly we feel a strong need to be financially secure as we approach retirement age. We have no inherited wealth, but only the savings from our earnings

"...we decided to place a substantial part of our savings in "safe" investments in Municipal Bonds backed by the full faith and credit of state and local governments...

"Perhaps we would be no worse off if we, like Government, had been profligate spenders who lived beyond our means..."

Louis E. Schmidt  
5504 Galbraith Apt. 49  
Cincinnati, Ohio 45236

"...I keep trying to explain to my wife that I wasn't speculating..."

Robert J. Sperber  
140 Lockwood Avenue  
New Rochelle, NY 10801

"...we are not business people (and not rich)--both of us are middle income municipal teachers who live a modest life in the City...and denied ourselves many things in an effort to achieve some modest financial security..."

Mr. Dennis Sandman  
1917 East 8 Street,  
Brooklyn, NY 11223

"...At the moment these dividends are paying my food bills."

Barnard Searle  
106-D FINDERNE AVE.,  
Grandview Gardens  
Sommerville, NJ 08876

"...Municipal bonds are 'legal investments' for all public bodies, banking and insurance companies. Thus, I view them in the same light as Federal Treasury Notes, Savings Bonds etc. They are obligations of one of the branches of our 'Government.'

"...And, the fact is that the only thing that makes U.S. Treasury Notes any more solid than New York City notes (considering the fantastic nation debt) is the ability of the Federal Government to issue paper money."

Keith H. Steinkraus  
Professor Microbiology  
Cornell University  
681 Castle Street,  
Geneva, NY 14456

"...My wife is afraid all our savings will go down the drain if New York City defaults..."

"I would like you to know the money I invested in these Municipal Bonds was hard earned money that had been saved from a salary..."

John M. Tagliani  
18 Hillcrest Road,  
Tenafly, NJ 07670

"When we retired, we took the cash savings we had in our retirement funds and placed them in New York City and State Bonds..."

"We were impressed with the fact that the whole credit and credibility of the community, city, state and nation supported the probity and security of our loan."

Dr. Abraham Tauber  
441-16 North Broadway,  
Yonkers, NY 10701

"I just can't believe it. We were always taught to put our money in the safest places. And we thought that one of the safest placed would be the cities and towns of this great nation. Certainly as safe as the banks in which we lost a great deal when we were much younger."

Sally B. Wyner  
15 Bound Brook Road,  
Newton, Mass 02161

160,000 Estimate Based on Leberthal & Co., Inc.'s Sales of 5% of City's Bonds  
To 12,000 Individuals

The conclusion that no less than 160,000 such individuals own New York City's long term debt has been arrived at by a physical count of certain of our business records and extrapolations made therefrom. Let me explain.

Since 1966 we have maintained copies of confirmations of sale to individuals filed by the date the bond sold matures. By counting the par value of New York City bonds sold to individuals maturing in three representative years and comparing the sum against the total city debt maturing those years, we have determined our share of the market.

Of the \$718,763,240 in bonds the city has maturing in fiscal 1978 (July 1, 1977-June 30, 1978), Leberthal & Co., Inc. has placed \$33,418,000 or 4.65% of the 1978 maturity with individuals.

Of \$733,779,240 maturing in fiscal 1980, Leberthal & Co., Inc. has placed \$35,420,000 or 4.8% with individuals.

Of \$210,311,240 maturing in fiscal 1985, Leberthal & Co., Inc. has placed \$17,874,000 or 8.5% with individuals.

The longer the year of maturity, the greater the percentage of bonds maturing in that year Leberthal & Co., Inc. appears to have sold. But giving proper weight to the fact that 49.6% of the city's long term debt matures within 5 years, and 77.5% within ten years, I calculate that we have placed with individuals an average of approximately 5% of the bonds New York City has maturing in all years. The grand total of the city's outstanding bonded debt is \$7,350,610,000 principal value. Five percent of that amount sold by Leberthal to individuals comes to approximately \$367,500,000. Because the individual usually buys to hold to maturity--less than 5% of our customers sell their bonds back to us before maturity--it may be presumed that most of the bonds we have sold are still reposed in the customer's safety deposit box.

We know the number of bonds and the percent of the city's long term debt we have sold.

We know the number of individuals to whom we have sold New York City bonds. Again a physical count made by each salesperson of customers, has determined that we have sold New York City bonds to no less than 12,000 individuals in the past nine years.

The next step is to project 12,000, the ownership figure which we know to represent 5% or 1/20th of the city's outstanding bonds into a total individual ownership figure. And here, because I cannot speak for other firms in the Municipal Bond Industry, I must fall back on "soft" statistics.

Leberthal & Co., Inc. numbers 13 active salespersons, myself included. Our sales staff has never been more numerous than 16. If 13-16 salespersons in the Municipal Bond establishment account for the placement of New York City bonds in the hands of 12,000 individuals, this Committee may project for itself the total number of individuals to whom the rest of our industry may have sold New York City bonds.

As a starting point, if one hypothesized that New York City bonds were owned by none other than individuals, then 20 times 12,000 or 240,000 is the maximum number of individuals owning the bonds. Obviously this number would have to be reduced by the percentage of the city's bonds owned by banks and other non-household owners.

It is my opinion that non-household ownership accounts for one third of the city's outstanding bonded debt.

The other two thirds in my opinion are owned by individuals.

In other words, 66% of the city's grand total of \$7,350,610,000 outstanding bonds or \$4,895,000,000 principal value, are owned by 160,000 (66% of 240,000) individuals.

I feel that any error in these computations is biased towards conservatism. We have produced statistics (appended hereto as Exhibits C and D) which show a market potential among individuals much greater than 160,000 households. As we have already indicated, and the Exhibits spell out in detail, the market for a tax-free bond expands and contracts in relationship to size of yield and the attractiveness of the tax free yield in relationship to yields of other investments that are taxable.

In 10 of the 21 issues of New York City bonds floated between Feb. 15, 1970 and the last issue dated Feb. 15, 1975, the 10 year maturity has produced an 80% tax-free to taxable yield ratio when compared to Aa-utilities available in the market at the same time. At an 80% yield ratio, we have already shown that 2,370,000 households in the 36% federal tax bracket are 25% better off in a tax free bond than with the after tax yield of a taxable bond.

#### The Human Consequence of Default

But one need not expand on the figure of 160,000 people to make the point. A default by New York City would be a human disaster whose consequences cannot be confined to the pine-panelled walls of the banking establishment. To people who have put their life savings into the full faith and credit general obligation bonds of an issuer, there is no difference between the loss of those savings and ruin by flood, dust, locusts, or a mortgage foreclosed on a homestead.

These letters from New York City bondholders speak for themselves:

"My investments in NYC municipals as I believe your records will indicate amount to \$17,169.92...

If I were to lose all this investment, it would be a terrible situation for me and family..." Anthony Cozza, 410 East 17th Street, Brooklyn, NY 11226

"We kept these moneys as a reserve to avoid going to an old age home. We don't want to impose upon the government for aid in our remaining years. If the city should default it will be chaotic for us." Samuel L. Goldstein, 32 Court, Brooklyn, NY 11201

"...If the city goes into default we are wiped out..." Reda F. Lindenbaum, 8511 Coventry Road, Brooklyn, NY 11236

"I cannot state too strongly the trauma which would result to me and my family if the city of New York defaults.

The money invested in good faith and feeling secure behind the promise of full faith and credit has become almost a nightmare of disbelief..." Phillip E. Marquis, 15 West 72d Street, New York, NY 10023

"Will you please--please save my Municipal Bond Money. I am over seventy years of age. I have worked very hard all my life--(fifty years)--before I went on social security.

I have lived very frugal. So in my old age I would not go on welfare. I will die before I will apply for that.

As a teenager in the last depression--1931--my hard working parents lost their home, right here in Jamaica.

Not being skilled--can you imagine the hours and years I worked (and supported an aged father) to save \$10,000, which we placed in bonds." Margaret S. Marshall, 8911-153rd Street, Jamaica, NY 11432

"My life savings of \$25,000 are invested in tax free U.D.C. and New York City bonds...

If I lose that I shall be forced to sell my home and go on public welfare... It is no wonder that the suicide rate among the elderly is increasing sharply..." Curtis M. Marx, 311 Broadway, Newburg, NY 12550

"All my income except my social security and musicians union pension of \$24.00 per month come from the city I love, namely N.Y.C. municipal bonds. I am frightened at the prospect of this city defaulting..." Charles Magnante, 19 Taconic Road, Ossining, NY 10562

"...This is my life savings Mr. President and without this income of \$3700.00 a year I will be living from hand to mouth after a 45 year struggle..." Harry C. Olson, 2152 Houghton Avenue, NYC 10473

"...I am an unemployed widow who is sending a child to college and I felt secure in investing in New York City. Now I just count the days until my bonds mature and pray that every day I will get my money..." Helen Resnick, 164-32 76 Road, Flushing, NY 11366

"...If there should be default, what can the aged count on? The banks will be taken care of by being able to borrow on their City Bonds from the Federal. Do the senior citizens have the same recourse?..." Mrs. Claire Stern, 488 Ocean Parkway, Brooklyn, NY 11218

"I have \$60,000 in New York City bonds, a major portion of my estate. I am 61 years of age. Have had surgery, radiation & am now taking chemo therapy for lung cancer. I have not been able to work for 1 year & the future is quite bleak. My medical expenses are enormous. Loss from the bonds would be a disaster." S. A. Waldman, O.D., 105 Fillmore St., Denver, Colo 80206.

"I am writing on behalf of my father-in-law. He is 89 years old, practically blind and living in a retirement hotel.

A substantial portion of his income which he needs to pay his living expenses is derived from about \$50,000 of NYC Municipal Bonds.

If this source of income should be cut off, he would probably have to apply for some form of welfare assistance. Since he resides in New York City, this would only add to the City's burdens..." David S. Walker, 54-25 253 Street, Little Neck, NY 11362.

Loss of Confidence--A Fire That Leaps the Road

I offer whatever further information from our records will help this committee arrive at a state of mind to avoid the personal tragedies these people fear. And this is not to diminish the economic consequences of a New York City default to the nation as a whole.

One year ago, according to the Bond Buyer publication's 20-Bond Index, the average tax-free Municipal Bond was yielding 6.52%. The index this week is 7.48%. 96/100 of one percent higher, when most other interest rates throughout the economy are lower than they were one year ago. Nothing other than the New York City financial crisis accounts for municipal rates going one way while all other rates in the land go the other. Loss of confidence is a fire that leaps the road, and the mere prospect of default by New York City imperils the Municipal Bond as a viable low cost instrument for building our schools, digging our sewers, and paving our roads.

By crude scratchpad arithmetic, one full percentage point applied to \$22.7 billion, which is the volume of Municipal Bonds that were issued last year, results in \$1.8 billion in just extra interest charges alone over the 8 year life of the average municipal issue. But I will leave to economists the business of quantifying the true price our municipalities will have to pay 1) if New York City defaults, and 2) if in a default, the courts should take anything less than the merciless attitude of Simon Legree in upholding the rights of the bondholder.

Although the banks still own the major portion of the \$207 billion outstanding long and short term state and local debt, it is to the households of America that every State, every country, every parish, every city, town, village, school district, sewer authority and irrigation district must turn for the financing of those new public works which are not erected by the federal government itself. (According to The Bank of New York's Money Market Comments of June 16 and September 22, 1975 individuals accounted for 56.9-58% of the net acquisitions of new municipal offerings in 1974, 95.2% in the first quarter of 1975, and 45% in the second quarter.)

The common sense words of the individual investor himself must be heeded:

"...people believed in the legal obligation of city and state to repay the principal and pay the interest on those bonds; they believed in the advice of politicians and brokers that general faith and credit of city and state stood behind the obligations.

To be told now that this was not the 'real world' is incredible. Default would mark a decline in confidence and trust that would extend to all financial markets." Walter Guzzardi, Jr., 57 Park Ave., Bronxville, NY 10708

"...Never for sure back to municipals..." Edith R. Keller, Glenmere Avenue, Florida, NY 10921

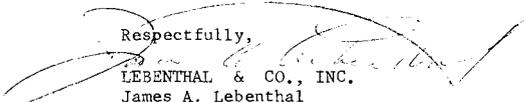
"...Certainly people in our situation will think more than twice about putting more funds into any other municipal offering..." Mr. and Mrs. R. Merrett, 195 Beresford Rd., Rochester, NY 14610

"...If the City of New York is allowed to default, because of Federal Government inaction, the financial loss would be staggering. But the real loss would be a loss of confidence. What incentive would any investor have to buy the bonds of any other municipality?..." Irving Kreindler, 2074 Cropsy Ave., Brooklyn, NY 11214

"...I hope that the Federal Government and the State Government will join hands and devise a plan whereby confidence will be restored in the integrity and fiscal responsibility of New York City and our other great cities which will be next in line if New York City collapses. Without confidence in the long range liquidity of our municipalities, banks, investment companies, insurance companies and the millions of small investors like myself will be unwilling to provide the funds needed for future development and improvement of our cities, large and small...

...if we let the New York City economy collapse, it will have extremely serious repercussions throughout our economy. Municipal Bonds will suffer first through unavailability of buyers and excessive interest rates. Other large cities will have to default also through inability to turn over their indebtedness as bond issues become due. But most important, faith in the integrity of municipal government, State Government and the Federal Government will suffer a serious blow." Keith H. Steinkraus, Professor Microbiology, Cornell University, 681 Castle St., Geneva, NY 14456

Respectfully,



LEBENTHAL & CO., INC.  
James A. Lebenthal  
Executive Vice President

October 13, 1975

Letters and Exhibits Appended.

Exhibit A--Letters from owners NYC bonds  
Exhibit B--Outstanding New York City Bond Debt by Maturity  
Exhibit C--Tax Free Versus Taxable Yields  
Exhibit D--Statistics on The Municipal Bond Market

EXHIBIT D

STATISTICS ON THE MUNICIPAL BOND MARKET

(Number of Taxpaying Households in U.S. Benefitting From Tax Free Municipal Bonds by the Size of the Benefit Received.)  
(Based on 1971 Internal Revenue Service Data Updated to Reflect Impact of Inflation on Incomes)

The investor in tax-free bonds accepts a lower yield than might be obtainable at the moment from comparable quality investments--historically 70% less. But he hopes to gain more in federal and state income tax savings than in the interest foregone. When for reasons of, say, adverse municipal market conditions municipal rates are high in relationship to other investments which are taxable (higher than 70% ratio of tax free to taxable), two things happen. One, for existing investors in any given tax bracket, the Municipal Bond produces a commensurately bigger advantage over the net return after taxes from the taxable alternative. Two, market for Municipal Bonds expands by extending the benefit of tax exempt bonds to individuals in tax brackets who might never before have given Municipal Bonds a passing thought.

GROSS INCOME	TAXABLE INCOME	FEDERAL TAX BRACKET	NUMBER OF HOUSEHOLDS IN BRACKET	ACCUMULATIVE NUMBER OF HOUSEHOLDS IN BRACKET OR HIGHER	YIELD RELATIONSHIP OF TAX FREE MUNICIPAL TO TAXABLE INVESTM'T (Tax Exempt as Percent of Taxable Yield)*									
					66%	68%	70%	72%	75%	80%	85%	88%	90%	
\$12.7M-17.5M	\$8M-12M	22%	14,690,000	30,680,000	N.A.	N.A.	N.A.	N.A.	N.A.	2	8	12	15	
\$17.5M-22.3M	\$12M-16M	25%	7,630,000	15,990,000	"	"	"	"	0	6	13	17	20	
\$22.3M-27.1M	\$16M-20M	28%	4,180,000	8,360,000	"	"	"	0	4	10	18	22	25	
\$27.1M-31.9M	\$20M-24M	32%	1,810,000	4,180,000	"	0	2	5	10	17	25	29	32	
\$31.9M-36.8M	\$24M-28M	36%	850,000	2,370,000	3	6	9	12	17	25	32	37	40	
\$36.8M-41.6M	\$28M-32M	39%	450,000	1,520,000	8	11	14	18	22	31	39	44	47	
\$41.6M-46.4M	\$32M-36M	42%	280,000	1,070,000	13	17	20	24	29	37	46	51	55	
\$46.4M-51.2M	\$36M-40M	45%	170,000	790,000	20	23	27	30	36	45	54	60	63	
\$51.2M-56.0M	\$40M-44M	48%	110,000	620,000	26	30	34	38	44	53	63	69	73	
\$56.0M-65.7M <u>AND OVER</u>	\$44M-52M	50%	510,000	510,000	32	36	40	44	50	60	70	76	80	

ADVANTAGE OF MUNICIPAL BOND OVER AFTER TAX NET TAXABLE BOND  
(Expressed as the Percent by which Investor is "Better Off"  
in Municipal)

Lebenthal & Co. Inc.  
Prepared October 13, 1975

## Exhibit B

## SUMMARY OF NEW YORK CITY BOND PRINCIPAL OUTSTANDING

Based on Comptroller's 1973-74 Report and updated by Lebenthal & Co., Inc. to reflect additional debt incurred by three issues since date of Report.

By Year Maturing During Fiscal Year ending June 30:	As Reported by NYC Comptroller '73-'74 Report	-----Updating Data-----			Total
		8/1/74	10/15/74	2/15/75	
1976	927,535,870	62,550	79,020	--	1,069,105,870
1977	844,512,240	62,550	79,020	22,710	1,008,792,240
1978	598,783,240	36,550	60,720	22,710	718,763,240
1979	427,998,240	36,550	60,720	20,710	545,978,240
1980	688,299,240	11,050	13,720	20,710	733,779,240
1981	440,178,240	11,050	13,720	2,710	467,658,240
1982	255,319,240	11,050	13,720	2,710	282,799,240
1983	225,860,240	10,150	12,720	2,710	251,440,240
1984	205,924,240	10,150	12,720	2,710	231,504,240
1985	191,631,240	6,250	9,720	2,710	210,311,240
1986	179,622,240	6,250	9,720	2,710	198,302,240
1987	199,555,600	6,250	9,720	2,710	218,235,600
1988	191,219,600	6,250	9,720	2,710	209,889,600
1989	171,661,600	6,250	9,720	2,710	190,346,200
1990	153,319,600	2,100	4,320	2,710	159,449,600
1991	115,985,600	2,100	4,320	1,510	125,115,600
1992	114,775,100	2,100	4,320	1,510	123,905,100
1993	79,105,100	2,100	4,320	1,510	88,235,100
1994	74,970,100	2,100	4,320	1,510	84,100,100
1995	71,255,100	2,100	4,320	1,510	80,385,100
1996	68,412,600	2,100	4,320	1,510	77,542,600
1997	74,947,600	2,100	4,320	1,510	84,077,600
1998	59,727,600	2,100	4,320	1,510	68,857,600
1999	54,261,600	2,100	4,320	1,510	63,391,600
2000	50,201,600	2,100	3,920	1,510	58,931,600
2001	46,586,000	2,100	3,920	1,310	53,916,000
2002	39,146,000	2,100	3,920	1,310	46,476,000
2003	33,256,000	2,100	3,920	1,310	40,586,000
2004	26,901,000	2,100	3,920	1,310	34,231,000
2005	21,551,000	1,000	1,720	1,310	25,581,000
2006	21,801,000	1,000	1,720	580	25,101,000
2007	22,136,000	1,000	1,720	580	25,436,000
2008	22,471,000	1,000	1,720	580	25,771,000
2009	22,876,000	1,000	1,720	580	26,176,000
2010	23,261,000	1,000	1,720	580	26,561,000
2011	23,256,000	1,000	1,720	580	26,556,000
2012	21,316,000	1,000	1,720	580	24,616,000
2013	35,038,500	2,500	1,340	1,210	43,088,500
TOTAL					7,774,803,170
LESS MATURED 7/1-10/1/75					424,193,000
					7,350,610,170
LESS NOVEMBER, 1975 DEBT					81,804,000
					7,268,806,170
LONG TERM DEBT OUTSTANDING AS OF 12/1/75					

Maturing 1976-80 4,076,418,830  
Less already matured 424,193,000

Outstanding 1976-80 3,652,225,830 equals 49.6% of debt maturing in first 5 years

Maturing 1976-85 5,695,939,030 equals 77.5% of debt maturing in first 10 years

Prepared by Lebenthal & Co., Inc.  
10/13/75

Exhibit C

TAXFREE YIELDS COMPARED TO TAXABLE ALTERNATIVES

REFERENCING YIELDS BY MATURITY OF ALL NEW ISSUE NEW YORK CITY BONDS DATED 2/15/70 TO 2/15/75

DATED DATE OF ISSUE	PAR VALUE OF ISSUE	YEARS TO MATURITY					BOND BUYER 20 BOND INDEX AT DATE OF SALE	ALTERNATE TAXABLE INVESTMENTS (In market as of date of NYC issues)				20 YR AGENCY	SELECTED TAXFREE TO TAXABLE YIELD RATIOS (Tax exempt as a % of taxable yield)		
		1 1/2	5 1/2	10 1/2	15 1/2	20 1/2		SAVINGS & LOAN	90-DAY T-BILLS	AA UTILITIES CURRENT CPN	10 YR CPN COVERNMENTS		5 1/2 YR NYC TD MAX BANK RATES	10 1/2 YR NYC TO AA UTILITY	BB-20 BOND INDEX TO AA UTILITY
2/15/70	\$176,860,000	6.00	6.75	7.10	7.35	7.40	6.53	6.00	6.75	7.88	8.69	7.50	100+	81.7	75.1
4/01/70	165,445,000	4.90	6.00	6.70	7.25	7.20	6.50	6.00	6.40	8.52	6.89	7.56	100+	78.6	76.2
7/01/70	170,180,000	5.25	6.50	6.75	6.90	7.00	6.28	6.00	6.36	9.04	7.56	7.56	100+	74.6	69.4
9/15/70	233,780,000	4.85	6.20	7.00	7.25	7.40	6.95	6.00	6.28	8.73	7.35	7.56	100	80.1	72.7
1/01/71	235,920,000	4.70	6.00	7.00	7.25	7.35	5.33	6.00	4.86	7.79	6.37	7.86	100+	89.8	69.1
4/01/71	258,110,000	3.75	5.75	6.50	6.75	7.00	5.21	6.00	3.64	7.35	5.48	7.13	95	88.4	70.8
7/01/71	357,100,000	6.00	7.00	7.45	7.65	7.80	6.19	6.00	5.18	8.03	6.40	8.13	100+	92.7	77.0
10/15/71	334,860,000	4.50	6.25	6.85	NR	NR	5.48	6.00	4.60	7.75	5.97	7.50	100+	88.3	70.7
1/01/72	376,800,000	4.00	5.75	6.30	6.60	6.70	5.23	6.00	3.65	7.22	5.96	7.00	95	87.2	72.4
5/01/72	255,220,000	4.00	5.75	6.30	6.65	6.80	5.54	6.00	3.64	7.50	6.11	7.12	95	84.0	73.8
7/15/72	267,200,000	4.25	5.90	6.30	6.50	6.70	5.44	6.00	3.96	7.55	6.12	7.15	98	83.4	72.0
9/15/72	303,950,000	4.00	5.50	5.95	6.00	6.05	5.16	6.00	4.54	7.55	6.36	7.15	91	78.8	68.3
1/01/73	293,980,000	3.50	4.85	5.25	5.45	5.50	4.96	6.00	4.90	7.30	6.33	7.20	80	71.9	67.9
5/01/73	285,360,000	4.25	5.05	5.25	5.60	5.75	5.07	6.00	6.10	7.56	6.65	7.36	84	69.4	67.0
8/01/73	331,075,000	5.50	5.75	5.85	5.95	6.00	5.48	6.75	8.30	8.48	7.22	8.03	85	68.9	64.6
11/01/73	369,970,000	4.40	4.70	5.00	5.40	6.10	5.05	7.50	7.25	8.02	6.67	7.57	62	62.3	62.9
2/01/74	349,143,000	4.50	5.00	5.15	5.60	5.75	5.26	7.50	7.42	8.17	6.93	7.81	66	63.0	64.3
3/01/74	436,620,000	5.50	5.85	6.00	6.10	6.20	5.75	7.50	7.52	8.26	6.98	7.87	78	72.6	69.6
8/01/74	324,900,000	7.00	7.30	7.35	7.35	7.40	6.70	7.50	9.74	10.15	7.70	8.85	97	72.4	66.0
10/15/74	475,580,000	6.50	7.00	7.25	7.50	7.60	6.48	7.50	7.82	10.10	7.53	8.74	93	71.7	64.1
2/15/75	141,440,000	6.50	7.00	7.20	7.30	7.50	6.27	7.75	5.44	8.80	6.94	7.95	90	81.8	71.2
10/03/75								7.67	7.67	6.25	9.62	8.30	8.75		79.7

**Lebenthal & Co., Inc.**

ONE STATE STREET PLAZA, NEW YORK, N.Y. 10004 - TELEPHONE 212 425-6116

MUNICIPAL  
BONDS  
FOR THE  
INDIVIDUAL  
INVESTOR

October 27, 1975

Senator William Proxmire,  
Chairman  
Senate Committee on Banking, Housing and Urban Affairs  
5241 Dirksen Senate Office Bldg.,  
Washington, DC

Dear Senator Proxmire:

I hasten to supply the following data to correct the impression that may exist on the Committee that New York City bonds are printed in \$10,000 denominations and, therefore, are not owned by small individual investors.

New York City bonds, as opposed to the notes (the smallest denomination of which were \$10,000), have been printed in \$5,000 denominations since the issue of 3/1/62. Prior thereto they came in \$1,000 denominations. Many \$1M pieces are still outstanding and owned by our customers.

Over the weekend, we counted this firm's 3,696 sales to individuals since 1965 of city bonds maturing in just fiscal 1977 (July 1, 1976-June 30, 1977) alone.

Breakdown of those transactions by par value of transaction is as follows:

<u>SIZE OF SALE</u>	<u>NO. OF SALES</u>
\$1M	214
\$2-4M	208
\$5M	1892
\$6-2M	39
\$10M	858
\$11-15M	178
\$16-20M	133
\$21-25M	124
\$26-30M	31
\$31-40M	31
\$41-50M	41
\$51-75M	19
\$76-100M	10
\$101M +	6

TOTAL 3696

60% of the above sales were in amounts of \$5,000 par value or less

66% were under \$10,000.

84% were of \$10,000 par value or less.

These 3696 separate transactions represent \$35,904,000 par value of sales, which is 3.6% of the city's \$1,008,792,000 total bonded debt maturing in fiscal 1977.

The hypothetical average transaction, obtained by dividing \$35,904,000 in bonds sold by 3,696 transactions, is \$9,714. In actuality, our median sale, as this study shows, is less than \$5,000.

Lebenthal & Co., Inc. has catered for 50 years to the smaller investor. One might want to give that fact consideration in projecting our bond sales pattern for 3.6% of the market into a larger picture for the rest of the industry. I would suspect other firms do larger per transaction business, but I myself would be hard pressed to speak for them, or attempt to quantify their sales by a similar analysis.

Respectfully,



LEBENTHAL & CO., INC.  
By James A. Lebenthal  
Executive Vice President

**CHIP** COMMUNITY HOUSING IMPROVEMENT PROGRAM, INC.  
575 WEST END AVENUE / NEW YORK, N. Y. 10024 / 212 - 799-9348

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October 23, 1975

IMPORTANT MESSAGE TO CONGRESS REGARDING NEW YORK'S FISCAL CRISIS

Dear Congressman:

During your deliberations about coming to the aid of New York City in its moment of dire fiscal crisis, we would urge you to consider the devastating impact rent controls have on the city's tax base. It is not enough to cut costs in New York by reducing services, welfare and capital expenditures, etc., in order to match expenses with income. The income must be reviewed with respect to insuring that the dollars expected are the dollars collected.

- NYC real estate taxes:
 

written off prior years (MAC) <sup>1</sup>	\$502,000,000
est. uncollectible 1975-76 (MAC) <sup>1</sup>	\$260,000,000
CHIP estimated uncollectible 1975-76:	\$400,000,000
- Number of apartment houses in tax arrears (HDA)<sup>2</sup> June 30, 1974 28,946

Real estate taxes for the fiscal year 1975-76 were projected at \$3,246,000,000. This amount has now been reduced \$260,000,000 by agreement of the Governor, State Comptroller, Mayor and City Controller. However, the \$260,000,000 figure is too low. We believe actual uncollected taxes will amount to more than \$400,000,000 due to the crushing impact rent controls and stabilization impose on New York City's private housing sector.

Rent controls are the main reason owners have been unable to pay real estate taxes. (28,946 apartment buildings were in default on the payment of real estate taxes on June 30, 1974.) Rent controls have caused the deterioration and abandonment of more than 300,000 apartment units in the last decade.

<sup>1</sup>Municipal Assistance Corporation

<sup>2</sup>Housing & Development Administration

*Representing 2500 Owners of 375,000 Apartments*

Annually, owners are abandoning buildings having assessed values exceeding \$100 million, an amount rising each year. For borrowing purposes, New York City values these same abandoned buildings at more than \$200 million based on "equalized assessed" value.

Part of the many billions of dollars of debt strangling our city and state include Urban Development Corp. and Housing Finance Agency bonds and notes for housing construction to replace abandoned housing at \$45,000 plus per apartment unit. All of this new housing is further subsidized by federal, state and city funds.

In a decision by Judge Bernard Klieger in the housing part of the Civil Court of the City of New York (copy enclosed), the Judge determined, "While cities without rent control may be suffering abandonments, it is clear however that in cities with rent control, housing units are being pushed over the brink and abandoned because of rent control." Further: "A rent gap approximating \$750 million has led to a deterioration in housing units, and enforced total abandonment of valuable property on an unprecedented scale. ...The City of New York is out some \$600 million in defaulted real estate taxes at a moment in its financial situation when every dollar is needed." And, "The testimony and exhibits at the trial established without contradiction or dissent that the administration of these laws has resulted in wholesale deprivation of property without due process of law, as well as denial of equal protection."

New York City is hiding not only the spreading bankruptcy of its private rental housing, but also its causes. We urge Congress to insist on all of the facts regarding the destruction of our city's real estate tax base resulting from rent controls before extending aid or guarantees.

We believe you will come to the same conclusion we have--New York City's fiscal crisis can not be dealt with effectively without restoring its real estate tax base. This can not be accomplished unless rent controls and stabilization are phased out now.

Sincerely yours,



William A. Moses  
Chairman of the Board

WAM:wrs  
Enc.

THE WEEKLY NEWSMAGAZINE OF Oct. 20, 1975

**TIME****THE NATION****CITIES/COVER STORY**

# HOW TO SAVE NEW YORK

## END RENT CONTROL

New York's housing has deteriorated alarmingly. More than 30,000 apartments are being abandoned each year. One major reason is the city's archaic rent-control law, which has been on the books since World War II. Because landlords in many instances cannot raise rents enough to cover costs, they simply walk away from unprofitable buildings, leaving them in the hands of the city, which can scarcely afford to rehabilitate them or even maintain them. With fuel costs high and climbing, abandonments are bound to accelerate. Real estate tax delinquencies are also ominously rising; they reached \$220 million in fiscal 1975.

Rent control must be phased out. That process could be combined with a modest building program to encourage home ownership in the city. Though more than a thousand acres of largely abandoned areas in The Bronx and Brooklyn are next to slums, they are potentially desirable because they are conveniently located. The city could clear them and erect row houses to be sold to middle-class buyers. Says I.D. Robbins, a builder and former president of the City Club, a civic watchdog group: "There is a tremendous capital investment left over from the time these neighborhoods thrived. All that is missing is people."

Excerpt from TIME Magazine, October 20, 1975

# BARRON'S

NATIONAL BUSINESS AND FINANCIAL WEEKLY © 1975 DOW JONES & CO., INC.

OCTOBER 27, 1975

## Rotten Boroughs

### New York City Has Been Undermined by Rent Control

DAN DORFMAN aside, New York Magazine isn't exactly most reading around here, but we subscribe wholeheartedly to last week's issue. Under the catchy title, "Who's to Blame for the Fix We're In", the author ticked off the "Twenty Critical Decisions That Broke New York City," ranging from enactment on June 22, 1944, of the G.I. Bill of Rights, which "opened the floodgates . . . to the exodus of two million middle-income people to the suburbs," to the default on February 25, 1975, of the New York State Urban Development Corp. In between, there was more than one villain of the piece: then-Governor Thomas E. Dewey; former Mayor Robert E. Wagner, who, on March 31, 1958, issued Executive Order Number 49, which granted city employees "the right to join a union of their choice and to bargain collectively"; Republican turncoat John V. Lindsay, who, on January 12, 1966, settled a city-wide transit strike at prohibitive cost, and, on March 18, 1969, "announced his candidacy for re-election."

Even Nelson Rockefeller, who has somehow bamboozled most of the press into forgetting his ruinous 15-year tenure in Albany, takes his lumps. March 28, 1960: "Governor Rockefeller signs a bill increasing by 5% the state's contribution to state employees' pensions"; April 18, 1960: "Governor Rockefeller signs a bill creating the State Housing Finance Agency"; June 18, 1971: "Rockefeller signs an amendment to the Local Finance Law," which, in effect, gave Gotham's free-and-easy politicians a blank check.

\* \* \*

Compiling Critical Decisions, of course, is a game any number can play. With respect to the decline and fall of New York, we can think of several that didn't make the aforesaid list. September 1, 1932: Mayor James J. Walker resigns from office, thereby temporarily removing Tammany's little tin box from the local scene and replacing it with the insatiable demands of social engineers and reformers. November 7, 1933: Fiorello H. LaGuardia wins the mayoralty by a landslide, thus enshrining the five-cent subway fare, sealing the doom of the Brooklyn-Manhattan Transit Co. (BMT) and Interborough Rapid Transit Co. (IRT), and ushering in an era of public affluence and private squalor. November 1, 1943: four months after the rest of the country, federal rent control goes into effect in New York City. May 1, 1950: New York State takes over the administration of rent control from the federal government. May 1, 1962: New York City takes over the administration of rent control from New York State.

Apart from Barron's, which for over a decade has repeatedly attacked this peculiar form of urban blight, and *The Wall Street Journal* (which lately has taken up the cudgels, few have cared to point a finger at rent control. The captains and the kings of high finance have tramped to Washington and departed, without so much as a passing glance at the subject. On Capitol Hill, where the lawmakers, as is their wont, again seem eager to legislate in haste and repent at leisure,

New York City has been undermined by rent control. Three decades of "emergency" curbs cost nearly \$1 billion in uncollectible real estate taxes, devastate much of Manhattan, Brooklyn, the Bronx. Civil Court judge condemns system as unworkable, unconstitutional. Gotham literally must put house in order.

—Editorial Commentary

Representatives and Senators alike unanimously have chosen to ignore the issue. Yet as our own chronology of Critical Decisions suggests, it cannot escape its share of blame for New York's financial plight. On the contrary, thanks to rent control, the city currently is losing—either by forfeiture or failure to collect—real estate tax revenues put at hundreds of millions of dollars per year. All told, what Gotham has lost from this source is fast approaching the billion dollar mark.

But the damage cannot be properly assessed in dollars-and-cents alone. As even the hapless officials responsible now reluctantly concede, rent control is costing the City of New York, through abandonment and ultimate destruction, upwards of 30,000 dwelling units annually. That's enough (so our colleague, James Grant, recently calculated—*Barron's*, April 21, 1975) to house at two to a room the population of Sioux Falls, S.D., or a good many other places the residents of which are now being asked to succor (or be suckered by) the misgoverned metropolis.

Like the quantity of shelter, the quality of life in the big town inevitably has suffered, too. Mobility and freedom to choose where one wishes to live have dwindled almost to the vanishing point. By setting tenant against landlord and lavishing unearned benefits on a privileged minority of subsidized squatters, rent control perennially fans the flames of social hatred and class warfare in a city once known as the nation's melting pot. After three decades and more of

an alleged "emergency," which furnished the shaky legal foundation for rent control, New York City is in deep financial crisis. One way or another, quite literally and finally, it must put its house in order.

"Disorderly" doesn't begin to describe the chaos wrought by rent control since it was imposed as a wartime expedient in 1943. While promptly abandoned by the rest of the U.S. shortly after World War II, the "emergency" measure remained alive and well in what somebody once described as the "most unrepresentative city in the country." Over the years, as noted, its care and handling, growing more cumbersome and restrictive every step of the way, shifted from federal to state to local authorities. First applied only to pre-war apartments, controls (rechristened "stabilization") eventually engulfed postwar buildings too, thereby bringing new residential construction in the five boroughs almost to a halt. Rules and regulations proliferated. As the landlord told Barron's, in one apartment house in the Bronx, "there are rent-controlled tenants, rent-stabilized tenants, tenants who were decontrolled by virtue of vacancy decontrol (since rescinded) and tenants who were recontrolled or restabilized by virtue of the Emergency Tenant Protection Act of 1974." Confusion has compounded to the point where a justice of the Civil Court of the City of New York recently decreed rent control—notably in its current version, known as Maximum Base Rents — unconstitutional, not because it violates property rights per se, but because it has grown impossible to administer with even a pretense of equity.

Maximum Base Rents may be shrouded in red tape, but their effects are painfully clear. Under such strictures,

landlords, after protracted delay, are lucky to win a rent increase of 7.5%-8.5% annually. In striking contrast, taxes and labor are rising at well over 10% per year, while in the past 18 months, the price of fuel oil, a ponderable part of total operating costs, has soared by 200%. Small wonder that more and more buildings are being run at a loss, while tax delinquency, once largely confined to one or two rotten boroughs, has spread far and wide. According to the Municipal Assistance Corp., newly organized state agency which is trying more or less successfully to fight City Hall, \$502 million in real estate taxes from prior years must be written off. In the current fiscal year alone, MAC estimates that another \$260 million will not be forthcoming, a staggering sum which the Community Housing Improvement Corp., a landlord group which knows the grim score, views as too low by half.

Deterioration—in the trend of tax delinquencies cited above, and in the condition of the housing stock—is shocking. Half a decade or so ago, Barron's observed: "Vast stretches of real estate in at least three of the five boroughs have decayed beyond the point of no return. Ancient tenements and (until recently) quite habitable buildings alike stand empty, boarded up and stripped, vandalized and blackened by fire. Some no longer stand at all except as piles of broken brick and rubble. Whole blocks of Brooklyn and the Bronx have been compared (by expert witnesses) to the bombed-out ruins of London and Berlin." Last spring, in preparation for weighing the case against rent control, Civil Court Judge Bernard Klieger toured the blighted areas. After an hour or two, he called a halt, saying:

"I don't want to see any more. I'm so depressed." Since January 1, precisely 2,696 dwelling units, only a handful privately financed, have been started in New York City, down over 50% from the like 1974 span. Physically as well as financially, Gotham is visibly crumbling.

\* \* \*

The moral devastation is worst of all. In the name of social justice, landlords—including some of moderate means—have been forced to subsidize well-to-do or wealthy tenants who, thanks to rent control, have turned large apartments into part-time pied-a-terre. For those seeking a place to live—this helps to explain why so few want to move to New York—freedom of choice is limited; in the covert traffic in rent-controlled flats (as must happen where goods or services are priced below market), discrimination, religious and racial, flourishes. For more than a generation, local politicians and so-called civic leaders alike have cravenly perpetuated the evil. Now the rest of the country is being asked to pay for the city's mistakes. If a bargain is struck, an end to rent control should be a key element of the *quid pro quo*.

—Robert M. Bleiberg

BARRON'S

October 27, 1975

## The First Condition

We think Senator Proxmire's Senate Banking Committee is making a mistake in envisioning a federal guarantee of New York City securities. But the committee will plunge beyond a mistake and into sheer folly if it guarantees the notes without securing the tax base that must pay them off. This means requiring the city to repeal its rent control laws.

We continue to believe that the best step for the city is voluntary bankruptcy, and that if it is unwilling to take that step the federal government ought to step aside and let the courts handle the problem. Mayor Beame talks of needing a billion dollars by March even if all debt service is suspended; this is chiefly the result of seasonal patterns in the payment of state and federal monies that could perhaps be corrected. In fact, the same projections show that through the remaining nine months of the fiscal year, a suspension of debt service and an 8% cut in other city spending would balance income and outgo.

These numbers are not significantly different from those the Proxmire legislation contemplates. The most important difference is that if the city goes through bankruptcy and is forced to live without credit, the cuts actually will be made. If it receives a federal guarantee, Mayor Beame will come limping back to Senator Proxmire next year for new and bigger guarantees.

We might remind the committee what a guarantee means. It means that if the city is unable to pay off the notes, the federal government must do so. The legislation would in effect set up a new uncontrollable federal expenditure of \$6 billion. Since the committee hopes that the expenditure will not be necessary, it recognizes that it must attach stringent conditions concerning the expenditure side of the city's budget. But so far it has not recognized that the same scrutiny must be applied to the revenue side.

The revenue side is at least as scary as the expense side. Earlier this year three disinterested civic associations—the Citizens Housing and Planning Council, the Citizens Budget Commission and the Citizens Union—issued an unprecedented joint statement warning of "the virtual collapse of the housing inventory of New York City and a massive erosion in the property tax base which would have a devastating impact on the city's revenue-raising abilities."

"Collapse . . . massive erosion . . . devastating," the words describe the recent effects of rent control, which has clung on in varying forms in New York though it was abolished soon after World War

II in the parts of the nation now asked to guarantee the city's debt. There is no better example of the habit of preposterous cant at the root of New York's problems than the rhetoric about "greedy landlords," which obscures the huge importance of the real estate industry to the city's tax base and credit standing.

The real estate tax remains the most vital single revenue source in New York. Some 31% of the city's assessed valuation and a somewhat smaller part of revenues come from apartment properties. The value of these properties, and thus their contribution to assessed valuation and their tax-paying abilities, depends principally on their rental income. The rent control and rent stabilization laws reduce this income, and thus reduce the city's tax base, revenues, and ability to redeem securities.

This chronic problem erupted into a full-fledged crisis with the increase in fuel costs, and other inflationary pressures, and with the reimposition of rent stabilization on apartments previously exempted from the older rent control law. The apartment owners have not been allowed to pass along the full increases in fuel costs in higher rents. The typical apartment is now operating at a loss. If in order to make a basic point we may be allowed an exaggeration ignoring such complexities as tax losses: This means the value of the property is zero, and the assessed valuation of the city ought to be written down by something approaching 31%.

A de facto write-down is rapidly making itself felt. About 25% of the apartment buildings are already in arrears on their real estate taxes. About 90 of the city's 125 subsidized Mitchell-Lama projects for middle income residents are in various stages of default on their mortgages. A rent strike at the huge Co-op City development, backed by many members of the city government, is the principal reason the State Housing Finance Agency is in financial jeopardy. The outright abandonment of apartments runs at about 40,000 housing units a year, or the equivalent of the entire housing stock in many smaller cities now asked to guarantee New York's debt.

Unless rent control is repealed, this hemorrhage will not only continue but accelerate. The city is devouring its own tax base just at the moment it is asking the rest of the nation to co-sign notes that base is supposed to pay off. Making the end of rent control the very first condition of any federal action is not a matter of ideology, but a matter of simple prudence.

THE NEW YORK TIMES, SATURDAY, OCTOBER 25, 1975

# The New York Times

Founded in 1851

ADOLPH S. OCHS, *Publisher 1896-1935*

ARTHUR HAYS SULZBERGER, *Publisher 1935-1961*

ORVIL E. DRYFOOS, *Publisher 1961-1968*

## Housing New York

Does this city want more housing? Does it want to maintain and upgrade the housing it already has, and at the same time promote a cycle of renewal, replacing economically weak structures?

Bit by bit over the past thirty years city policies have inhibited such a cycle, which is essential to municipal health. Rent controls, for example, may have performed an essential protective function for hundreds of thousands of families, but they have also inhibited renewal. So have tough relocation procedures. So have the restraints on conversion of buildings to cooperatives or condominiums.

A heartless overnight reversal of policies deeply inscribed in the city's way of life is obviously impossible, but there must be a gradual turn toward realism to stimulate housing investment.

As a first step, it may be necessary to take administration of the control system out of the hands of political officials and vest it in some counterpart of the Public Service Commission, which regulates utility rates. In the last disastrous eight years of housing administration, city government has shown itself incapable of managing the burden of so vast and diverse a housing supply.

Beyond that, a way must be found to phase out controlled rents without unduly penalizing fixed-income elderly people who cannot afford the real cost of their housing or others unable to find decent housing at supportable rents. The new so-called Section 8 Federal rent subsidies should be useful in this respect.

Without question, the fuel-cost crisis has brought the situation to a head. There must be long-term incentives to maintain sound housing despite the corrosive effects of leaping operating and financing costs. The city's tax base itself depends on it.

reprinted from **BARRON'S**

National Business and Financial Weekly Issue of April 21, 1975

## Disaster Area

### Rent Control Has Helped Turn Gotham Into One

By JAMES GRANT

**T**HE fiscal plight of New York City, a serialized drama of uncertain length (and which may or may not have a happy ending), has gained national notoriety in recent weeks. Early this month, Standard & Poor's Corp. suspended the city's credit rating. Only the timely arrival of state aid—some \$400 million which Albany itself had to borrow—saved Gotham from an imminent, and perhaps disastrous, trip to the credit market. Late last week, City Hall proposed a 1975-76 budget of \$1.3 billion, including a projected deficit of about \$880 million.

One aspect of the continuing financial crisis, however, has been largely ignored: the steady decline of New York's pre-war apartment buildings. Abandonment of old but still sound structures (to illustrate, the Brooklyn apartment house shown below) is sharply on the rise. Tax arrearages are mounting. Many pre-war buildings happen to be rent-controlled, a state of affairs which, landlords say, makes it impossible to keep them in good repair.

#### Apocalypse Ahead?

"Is N.Y. Housing Doomed?", asks the Real Estate Weekly on its April 3 front page. Doomed? One senses hyperbole; apocalypse, after all, is an idea perhaps too much in vogue. Yet the same question is posed, on the same front page, by none other than Roger Starr, New York City's Housing and Development Administrator. "What is our potential for housing 'disaster'?" Starr asks. "Why can one suggest that our housing stock may be reaching a point of no return?" Tax arrearages, abandonment and mortgage defaults worsen apace, he writes.

Starr places most of the blame on the soaring price of fuel. He warns that more deterioration looms unless the City Council passes along part of the higher oil costs to tenants—landlords to date have borne virtually the whole burden.

Fuel, indeed, has risen by 200% in the past 18 months; the cost of labor is up 40% in three years. Taxes alone are expected to increase 10% next year.

Yet rents—controlled in some instances, since 1943; successively "stabilized," "decontrolled," and "restabilized" in the years since 1969—have lagged behind. Estimates vary as to just how far.

The gap, without doubt, is widest in rent-controlled buildings, those apartments—about 700,000 remain—built before 1947. Though in one way or another virtually all city apartments are "controlled," the older stock is regulated most severely. Landlords and the city agree that rent-controlled tenants do not pay enough to maintain their own buildings. Citing a seven-year-old study by the Rand Corp., owners claim that the shortfall amounts to \$750 million a year—in effect, a tax on the bricks and mortar of older, rent-controlled apartment houses. The city declines to guess.

Most eloquent evidence that something is wrong is the spreading blight of abandonment. Last year, Starr has testified, landlords and tenants walked away from 36,000 apartments, enough to house the population (at two to a unit) of Sioux Falls, S.D. Starr bases his appraisal on a running count of vacant buildings kept by the Fire Department. Other estimates, pointing up the dearth of hard information, range from 15,000 to 50,000 units.

#### Last Exit to Brooklyn

Whatever the numbers, the spectacle of abandonment is haunting: in the Brownsville area of Brooklyn, block after block of vacant apartment houses, stripped of everything salable, stand rotting; 16-inch walls and hardwood floors, ornamental plaster-work and broken glass—deserted. To build an apartment in New York today costs about \$50,000; restoration of an existing unit, depending on its condition, can vary from \$15,000 to \$30,000.

Last month, Judge Bernard Klieger of the Brooklyn Civil Court agreed to view abandonment and decay firsthand in connection with an unusual trial. The inspection was to have included the Bronx and Manhattan as well as Brooklyn, but in Brownsville,

three hours after he began, the judge threw up his hands. "I'm so depressed," he said. "I don't want to see anything more." He likened the destruction to Aachen, Germany, in the closing months of World War II.

The trial began in December, when the Housing and Development Administration took a landlord's organization to court to block a symbolic, one-day boiler shutdown. The landlords, about 1,000 strong, had planned the action to protest municipal regulations of fuel pricing. It followed similar "Boiler Conservation Days" last fall.

#### Restraining Order

The city sought (and won) a temporary restraining order against the owners on December 5. However, Community Housing Improvement Program (CHIP), the landlords' group, filed a countersuit for \$750 million, a sum which, if awarded, would cause the most sudden austerity wave in the history of municipal finance. (Such an award is considered unlikely.)

The countersuit called for something more immediate—a wholesale, and possibly impolitic, review of the city's housing policies. Indeed, by the last day of the hearings, Roy Cohn—the of Army v. McCarthy, and Fifth Avenue Coach Lines v. New York—asked that the judge rule rent control unconstitutional, a breach of the guarantee that private property not be taken for public use without fair and adequate compensation.

HDA protested that the court lacked jurisdiction in a matter so sweeping. The setting was indeed improvable—a civil court judge in Brooklyn hearing arguments on the legal theory of rent administration. But Judge Klieger's jurisdiction was upheld in the State Supreme Court and the trial went forward. The hearings, which lasted six days, were concluded on March 19.

Judge Klieger only now is receiving final briefs; his decision is weeks away. Already apparent, however, is the toll that property abandonment and falling real-estate income have taken on the

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city's finances. Cumulative tax arrears reached \$648.5 million on January 31, up from \$522.3 million on the same date in 1974 and \$494.3 million on January 31, 1973.

#### Tax Arrearages

Last year's increase in tax arrearages (that is, the increase between February 1, 1974 and January 1, 1975), plus the 1974 cancellation of real estate taxes, totaled \$226.4 million. Arrearages plus cancellations in 1973 came to \$101.1 million, lower by half. (A cancelled tax is one that the city has either remitted or given up on.)

Most property owners, of course, pay their taxes; a fine of 1% a month is levied on uncollected balances and three year's non-payment is grounds for foreclosure. The city expects all but 6% of the \$2.896 billion it has budgeted for real-estate taxes this year (about a quarter of New York revenues) to be collected by June 30.

That is the bright side. Less appealing are these facts: a 6% delinquency rate, up from 5.59% a year ago, would be the worst in at least 40 years; non-payment by apartment houses, which provide 31% of the city's real-estate tax income, is running substantially higher. On June 30 last year, 21.8% of New York apartment house parcels had slipped into arrears, vs. 11.5% of all real-estate parcels. (Not all parcels, of course, are taxed equally.) "Among the older, walk-up stock," Starr writes, "tax delinquencies went as high as 33% in Manhattan—and even the

newer elevator buildings posted double-digit arrears in the Bronx (16%) and Manhattan and Brooklyn (11% for both)."

The city loses in other ways. Not only are delinquencies mounting, but also rent control reduces the taxes that might otherwise have been paid in a free market. Whatever the "rent gap" may be in controlled buildings—\$500 million, \$750 million or \$1 billion annually—New York loses some of it in taxes. Property taxes, of course, are not tied directly to rents, but a property's assessed value to a great degree reflects the income which it produces. If a "gross rent multiplier" of three is applied to \$750 million, for example, the "assessed value" comes to \$2.25 billion. At the present tax rate, the real-estate levy on such a sum amounts to \$165 million. Though the numbers are rough, the theory is sound: less income means lower real-estate taxes. If rents are depressed by law, so are taxes.

#### Bad Light

Obviously, none of this casts the city's tax anticipation notes in a flattering light. (On April 8, there were \$1.1 billion in notes outstanding, issued against future real-estate levies, but backed by the city's general revenues.) A building, though abandoned or in arrears, is normally carried on the city tax rolls until foreclosure. There arises the question of how much revenue the city may prudently anticipate. The answer, simply, is that no one knows; the

numbers — on abandonment, disinvestment, the "rent gap" — do not exist. Without question, though, the outlook for apartment houses in New York City is bad and getting worse.

Certainly, things could be better for Marian Catrina, owner of a five-story walk-up on 35-45 Arden Street in upper Manhattan. Over the past 12 months, he says, he has paid \$16,168.13 in real estate taxes. In that time, according to his figures, expenses have outstripped income by more than \$10,000. Some 40% of the families in his building, Catrina adds, are behind in their rent.

Of his 69 apartments, 39 are rent controlled—that is, based on rents that prevailed in 1943. (With allowable increases since 1943 and barring tenant turnover, a rent-controlled apartment that rented for \$60 a month 32 years ago would fetch about \$114 today.) Catrina estimates that his maintenance costs—taxes, oil, wages—come to \$40 a room, \$10 more than rents in controlled units. Monthly income for the other 30 apartments totals about \$45 a room, he says—enough to cover maintenance, but not to finance major improvements.

#### Minor Violations

Bruno De La Rosa, the su-



perintendent, says that the building has improved in the year under Catrina's ownership—ceilings have been fixed, there is new paint in the halls and the courtyard will soon be repaved. Still, the property has been cited for minor building-code violations and there is need for an overhaul: the wiring should be replaced, while the plumbing, Catrina says, "is a mess."

De La Rosa shows a visitor a vacant apartment, Number 2H. Red wallpaper, recently torn from the walls, lies wadded on the floor. The medicine chest is gone, taken by the former tenant who also is said to owe two months rent. (Tenants have stolen toilet seats, electrical fixtures and refrigerators, Catrina says.) There is a sticker on the inside of apartment 2H; it reads "Have a Nice Day."

Catrina's building is located in Inwood, a few blocks from The Cloisters. The neighborhood is poor, largely black and Hispanic, but it is not a slum. "It's a fairly decent place," says an officer at the 34th Precinct; "there aren't too many incidents."

Catrina, who emigrated from Romania six years ago, is frightened and frustrated. Though he put down \$30,000 for the apartment house—his only such holding in New York—he says he may turn the title back to the bank and walk away. The mortgage is for \$312,000. "I do the work here, the plumbing," he says.

"Still the people are hating you, blaming you I'm fed up."

In another part of town, another landlord recites his woes. The building is 2-24 Hinkley Place, a six-story, seemingly prosperous brick elevator apartment house in residential Brooklyn. The landlord is Sandy Sirulnik, president of Ditmas Management Corp. Sirulnik, whose family has owned New York real estate for three generations, stands on the sidewalk in front of the building, answering newsmen's questions. The occasion is Judge Klieger's tour of city housing, and Sirulnik is explaining the mechanics of losing money.

#### Caught in the Tunnel

"The building is violation-free, it's been upgraded for air pollution," he says. "Sixty-five of the 82 apartments are rent-controlled. All but one apartment is rented." Sirulnik says he is feeding the building fresh capital every month, and that out-of-pocket expenses have totaled \$20,000 since July 1973. Fuel costs have more than doubled—from \$7,357 in the fiscal year ended July 31, 1973, to \$19,997 for the 12 months ended July 1974. There have been increases in taxes and salaries and maintenance. Rents have risen as well in that last year—from \$112,029 to an indicated \$121,034 at present—but not enough to keep pace.

"We'll wind up basically in the same situation as last year," Sirulnik says. "I feel the only way to go is to see the first mortgage—to seek suspension of amortization payments on the first mortgage. If the bank doesn't go along we'll give them the first mortgage. If there were a light at the end of the tunnel, things would be different. But the tunnel's blocked up with cinder block and I don't want to be caught inside. I don't want to throw good money after bad."

#### Equity Has Disappeared

Ditmas owns 4,200 apartments in New York and substantial commercial properties outside the city. The Hinkley Place apartments, built in 1929, have made money regularly since the family acquired them in 1950. In 1972, Sirulnik guesses, the building might have sold for \$500,000. "Now, I doubt I could get what the mortgage is worth—\$260,000." His equity—\$240,000—has disappeared. How long will he hold on? That depends on what happens in Albany and City Hall, Sirulnik says.

According to Sirulnik, his family has never walked away from a building. Aaron Ziegelman cannot make the same claim, and last month he sat in Judge Klieger's courtroom to explain why. Over the past 12 months, Ziegelman testified, he "abandoned" 15 apartment buildings—gave up the properties at distress prices or allowed mortgages to foreclose.

He told the court he is losing money on 67 of his remaining 70 buildings, all of them in solid, middle-class neighborhoods.

"I'll tell you how this process takes place," he began. "You know, a building just doesn't become abandoned, abandonment where it's a shell. I own a building where I have no future in it and I see no future. See, the worst part is not only losing money, it's the lack of expectation."

"I'm in a position where because I do a lot of business out of New York City, I have the capital, the financial ability to keep a building even though it loses money, if I have expectation. But if I have no expectation, I'd be a damn fool to hold on to it. I could sell it to someone with very low cash just to get out and take as much as I can and salvage as much of my investment. And there the process of deterioration starts, because the building now goes from strong hands like ours—and I consider ours good, strong management, financially viable—to weak hands."

#### Sense of Futility

Are the problems of Catrina, Ziegelman and Sirulnik typical? They are at least representative. Well-managed buildings in desirable neighborhoods can and do make money in New York City. But these, by all accounts, are in a dwindling minority. A sense of futility has come over the industry, something that goes beyond the rise in fuel prices. There is a belief that the City no longer cares, that the needs of property are not merely neglected, but scorned. "Expectation" has all but vanished.

"From all the years I've been in business, I've always heard landlords cry," says Jack Weprin, a housing lawyer. "Now not only are they crying, but they're giving up their properties too."

He adds that with vacancy decontrol, a 1971 law that mandated the gradual freeing of controlled rents, "you felt a resurgence of hope. . . . People who had gotten out of the New York market were coming back in. They felt they could operate and make money."

#### Backlogs of Years

But the reform was scrapped with the 1974 Emergency Tenant Protection Act. A city plan of "maximum base rents," designed to secure a fair return for the owners of controlled buildings, has been indifferently administered, the city concedes. Landlords say that backlogs, notably for "hardship" cases, sometimes can be measured in years. Delays in getting out the 1974 "MBR" increases sharply worsened an already strained cash-flow situation, owners charge.

According to HDA's Starr, moreover, 55% of the city's controlled buildings failed to qualify for last year's rent increases because of maintenance infractions.

The city housing courts, created by the legislature in 1973, play a pivotal role in deciding when and if contested rents shall be paid. Judge Edward Thompson, deputy chief administrative judge in charge of the civil court, concedes that a bias exists in favor of tenants, not merely in housing court, but also "throughout the city."

"It's normal for a judge to side with tenants," he says. So important is housing to man's well-being that such an "understanding," is normal and just, he declares. Landlords, for their part, say that the system hampers payments and erodes their authority to collect them. If tenants have a right to decent housing, they ask, do owners have a duty to provide it, regardless of costs?

Far simpler than the administrative history of rent control is its economics: costs, which are not controlled, have outpaced rents, which are. For decades New York has sought to provide decent housing at low prices. But in pursuing this goal, it has slighted an axiom of economic life: government can regulate the price of a commodity, or it can regulate the supply, but it cannot set both at once. The city has seen to it that many New Yorkers pay a very low rent. (For example, some 10% of all controlled tenants pay only 13% of their income for rent, a landlords' group estimates, based on 1970

census data.)

But low prices call forth less investment and less production, whether the commodity is natural gas or apartment houses. And if prices are low enough, the result is disinvestment or abandonment.

On a net basis, New York City is losing about 10,000 apartments a year, HDA estimates. Construction during the 'Seventies has averaged only 20,000 units annually, down from an average of 37,000 in the 'Sixties. (Abandonment, in large part, accounts for the net decline.) Significantly, privately-financed housing has fallen both in absolute terms through 1972 (the year of the latest available figures) and as a proportion of overall construction. The result, the city reports, is "a critical and growing housing shortage."

To the federal government, if not City Hall, rent control signals danger. "It has been determined," the Department of Housing and Urban Development wrote in the February 26 Federal Register, "that local rent control is a significant factor in causing owners of FHA projects, especially subsidized projects, to default on their mortgage payments."

The result: rising mortgage insurance claims, HUD concluded, and abandonment. Some 53 federally-insured or federally-financed apartments houses in the New York region were in default on March 1, roughly twice the total a year ago. (There are 884 such projects in the metropolitan area.) According to S. William Green, HUD's New York administrator, most of the 53 buildings are rent-controlled. He says HUD is by-passing local laws to raise rents for most of the defaulted buildings' tenants, typically between 15% and 17%.

### Forbidding Rules

HUD's intercession is the latest change in the tortured evolution of New York housing law. So forbidding, so byzantine are the rules that govern the operation of a New York apartment house that few landlords can begin to understand them. James M. Peck, co-counsel for CHIP, cites the example of 2146 Barnes Avenue in the Bronx. Apartments in the building, he writes, fall under both rent control and rent stabilization.

"Further," he goes on, "there are units in the building which are exempt from either law. Two separate hardship provisions govern the tenancy of this building and there are two separate and distinct procedures for obtaining capital improvement increases."

There is more. "In the building there are rent-controlled tenants, rent stabilized tenants, tenants who were decontrolled by virtue of vacancy decontrol, tenants who are re-controlled by virtue of the Emergency Tenant Protection Act of 1974 and tenants who were restabilized by virtue of the Emergency Tenant Protection Act of 1974. "The situation," he concluded, "if not tragic, would be laughable."

That capital flees uncertainty is amply illustrated by Metropolitan Life Insurance Co., builders of the massive Peter Cooper and Stuyvesant Town developments on Manhattan's Lower East Side. The Met says it has not invested in New York City housing since 1971. "You can't rely on income if everytime you build something they slap a rent control on it," says William F. Leahy, vice president for real estate financing. "You can't control what you sell for and not control what you buy for without disaster."

# More Problems for New York City

By JAMES RING ADAMS

New Yorkers may think they have enough to worry about, with a double crisis this week over balancing next year's budget and raising enough ready cash to pay off \$251.4 million of notes due this Friday. But as the city's fever chart has soared, a much less spectacular malignancy has begun to affect New York's finances, threatening worse trouble ahead.

Throughout New York's perennial fiscal crises, its mayors have always been able to use a standard defense. By merely pointing to the mile upon mile of immensely valuable commercial, industrial and residential real estate, they have been able to prove the huge tax resources of this city. Unlike other financially troubled cities, the assessed valuation of New York's real estate has steadily risen, to nearly \$40 billion this year.

But in the last two years, rising costs, rent controls and tight money have combined to put rising numbers of apartment houses, which make up 31% of the tax base, deeply into the red. And the problem has spread from the low-income walk-ups of Brooklyn and the Bronx to luxury elevator apartments in the best sections of fashionable Manhattan.

"If left unchecked," said a recent warning from three civic groups, this situation "could mean the virtual collapse of the housing inventory of New York City and a massive erosion in the property tax base which would have a devastating impact on the city's revenue-raising abilities." The three groups—The Citizens Housing and Planning Council, The Citizens Budget Commission and The Citizens Union—had sought to dramatize the problem by the unprecedented step of agreeing on a joint press release.

According to estimates by the city itself, some \$220 million, or between 7.6% and 7.8% of the \$2.9 billion projected real estate levy for the current fiscal year will go uncollected by June 30, the end of the year. This means that 33,000 apartment buildings, 25% of all taxable multiple dwellings, will be in default.

## On a 'Slippery Slope'?

To the civic groups, this nonpayment is the first step on the slippery slope of "mortgage defaults, unpaid fuel bills, deferred maintenance and finally and inevitably, building abandonment and neighborhood decay." Mortgage defaults, they say, "are rising in all classes of housing in all boroughs." New York fuel suppliers have cancelled lines of credit of some 10,000 residential buildings. And abandonments are destroying from 35,000 to 50,000 housing units annually, depending on whom one talks to.

According to Finance Administration records, the city may take over title to nearly 6,000 buildings when the fiscal 1974-75 foreclosure proceedings reach their end.

The cause of this problem is hotly de-

bated between landlords and tenants, and that in itself is part of the problem in a city where 76% of the voters are tenants. Landlords single out the labyrinthine rent control restrictions of the city as the reason they haven't been able to cope with the calamitous sudden increase in costs. The city's rent control program dates from 1943. A separately-administered rent stabilization program was begun in 1970. At one point, the state legislature tried to redress the rigidity of the system by removing vacant apartments from rent control, but this was repealed in 1974 by the "Emergency Tenant Protective Act." Now some apartment buildings may have tenants in four different stages of control or decontrol.

"It's all absurdity," says New York University Professor Emanuel Tobler, who

*While Mayor Beame is wrestling with New York City's latest fiscal crisis, new signs of erosion are appearing in the city's celebrated tax base.*

is chairman of the stabilization program's Rent Guidelines Board.

Nevertheless, the political clout of the tenant voters makes it almost certain that landlords will never fully make good on the undiaped rise in their expenses recently. Fuel oil has soared from 14 cents to 38 cents a gallon since 1973 and utility bills have kept pace. In mid-May, the City Council approved a "fuel pass-along" bill, allowing landlords to charge tenants for 50% of this increased cost. But unmollified landlord spokesmen say the bill gives too little, two heating seasons too late.

Real estate taxes, which account for about 30% of a typical apartment's operating and maintenance costs, are beginning to hurt too. The current rate of \$7.35 per \$100 of assessed value is expected to reach \$8.09 next year. This tax rate is directly tied to New York City's mounting cost of debt service. And if the present rate of tax arrearages were to be factored in, says D. Kenneth Patton, president of the Real Estate Board, the rate would have to climb another 67 cents.

Samuel Lefrak, whose Lefrak Organization runs some 280,000 apartments in the New York area, thinks the crunch will be disastrous for small operators with high mortgages and less chance to benefit from the income tax benefits conveyed by some types of New York real estate ownership. He thinks his own organization "can live with rent control," thanks to an intensive two-year campaign to reduce corporate debt. But, he adds, "the highly leveraged people are going down the drain."

Professor Tobler himself believes that

rent control is only 10% to 20% of the cost squeeze problem. Controlled rents in the 1960s showed some flexibility, he says, increasing 34% while free market rents rose 52%. The real problem, he maintains, is the declining income level in the city, making it harder for tenants to afford the rents they do pay. (A recent Census Bureau study found an 8.3% decline in the city's average wage to \$10,039 in 1972 from \$10,961 in 1970.)

## Creeping Decay

Meanwhile, the process of decay has begun to creep into neighborhoods and types of buildings previously believed to be in relatively good shape. Professor Tobler, using previously untapped data, has analyzed delinquencies for the city's 122,000 walk-up tenements and 10,000 elevator apartments. Of the tenements—the most troubled and predominant part of the city's housing stock—predictably some 22% in the poorest quarter were in arrears. But in the richest quarter of the city, so were 18%. Some 16% of the elevator buildings were behind in their tax payments in the poor neighborhoods. Yet even in the rich districts, where this type of building means high-income luxury, some 7% couldn't meet their tax payments.

Since these figures were compiled, says Professor Tobler, "the situation has deteriorated even further. If present trends continue, by the end of the fiscal year in June 1977, the city might face bringing foreclosure proceedings on from 200,000 to 250,000 housing units, most of which are walk-up properties." (Total city rental housing is estimated at 2.2 million units, about half of which is in walk-up buildings.)

In theory the city would sell the buildings for whatever it can get, but Professor Tobler's figures predict that the city might find itself stuck with one-half to two-thirds of the housing stock in some neighborhoods. Many of the tenants may still be there, simply because it doesn't seem there will be any place else for them to go. The city vacancy rate is 1.5% and net new additions to the housing supply have averaged only 7,500 per year during 1968-73, and plans for new housing filed with the Building Department dropped to a staggering low of 226 units for the first two months this year.

The passage of such a large stock of buildings into municipal hands would make the city's Department of Real Estate the biggest slumlord in town. But, says Professor Tobler, "there's no indication they're thinking what to do about it."

What effect would all this have on the city's widely-discussed fiscal crisis? Obviously it won't help a city with a perennially unbalanced budget to have tax-paying private property transformed to a municipally-owned white elephant.

More immediately, non-collection of taxes puts greater strain on the city's short-term borrowing, which already is at the point of collapse. Roughly a quarter of the \$5.7 billion outstanding short-term debt consists of tax anticipation notes (TANs) to be repaid by real estate taxes. It's surely no comfort to creditors that the sum of all unpaid real estate taxes, including this year's projected delinquencies, approaches \$600 million.

(Leaving aside this fiscal year, the total of uncollected property taxes still exceeds the total of unredeemed TANs by some \$68 million. The city does manage to pick up some of this money through foreclosure sales or late payment, but a good proportion of back taxes is written off, as court-ordered abatements or simply as uncollectible.)

### **The Tax Deficiency Fund**

The full fiscal impact of the real estate tax problem won't be felt for several years. The city can "roll over" its TANs, that is take out new loans to pay off the old ones, for five years before the law requires it to settle the debt. If tax money isn't in hand then, the Tax Deficiency Fund makes up the difference. This fund normally gets its money from city departments which didn't manage to spend their full appropriations in preceding years. If this isn't enough, the city makes up the deficit. For the first time in several years, the city had to do this this year, with a \$29 million appropriation. This expense undoubtedly will increase in coming years.

Of course, there is always the chance that New York real estate will make a recovery. The city's delinquency rates are still less than economically stagnant Camden and Newark, N.J. and are far below the 26% rate they reached at the depths of the depression. Perhaps the fuel pass-along bill will do some good and New York landlords will once more demonstrate the astonishing capacity of humans to cope with an absurd system of economic regulation. But, failing this, real estate will become a major feature of New York's next financial crisis.

"The city of New York is going through a nervous breakdown," says Samuel Lefrak, "and now real estate is going through a nervous breakdown, too."

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*Mr. Adams is a member of the Journal's editorial page staff. An editorial dealing further with New York's problems appears today.*

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## Point of View

# 'Blind' Subsidies Must End

By **ALLAN R. TALBOT** Executive Director, Citizens Housing and Planning Council

The financial news these days may suggest that New York City is the great ship Titanic. It often seems that everyone except Mayor Beame, who is frantically searching for more money, is paralyzed, unable or unwilling to take the required steps or even to agree on what steps are required.

Diminishing tax income and ever-increasing expenditures are the problems facing the city, which—through its health, education, recreation and other systems—subsidizes its residents and others quite generously. The city is giving away more than it can afford.

Among the many areas in which it does so is housing. Using Federal and state funds as well as its own, New York subsidizes the housing costs of its residents like no other city in the world. This subsidy system—including underassessment, tax abatement, rent control, land-cost write-downs, interest subsidies, tax exemptions and welfare payments, among other things—is incomprehensible to many people. But the system's basic problem is its blindness—the subsidies often make no allowance for the ability of the recipients to pay.

Housing subsidies work in two principal ways. They either shift housing costs to the public treasury, as do tax abatement and interest subsidies for new construction, or they

require that building owners assume more of the costs than they would in a free market. Various rent control regulations are a prime example of the latter form.

The economic erosion of both public-sector and private-sector housing is caused primarily by the city's recent tradition of subsidizing as many residents as possible.

In these difficult economic times, it would appear sensible to ask resi-

annual rent income. Tenant organizations heartily dismissed the notion that residents in rent controlled buildings should assume any of the 30¢ per cent rise in fuel oil prices over the last year. Their political clout accounts for the City Council's delay on the fuel pass-along bill, though the oil price emergency was more than a year old.

Who was left holding the bag? Some building owners were, if they were

## New York gives away more than it can afford and makes no distinction between those who need it and those who don't

dents to assume a greater share of their actual housing costs if they can. Politically, that means taking away some privileges and benefits; it means controversy. The easier political course is to continue blind subsidies, allowing housing to go broke in both the public and private sectors.

An enlightening glimpse into the problem was presented by the City Council's recent passage of a bill under which tenants and landlords in rent-controlled buildings would share the cost of fuel oil when it exceeded a fixed percentage of the

solvent enough to absorb the price rise. Other owners decided to withhold their property taxes to pay the fuel supplier. Or worse, they turned off the heat, and the city's Emergency Repair Program was forced to come to the rescue.

In either of the latter cases, the ultimate subsidizers of rent-controlled housing were other property-tax payers in New York, most of whom were already bearing their share of heady fuel costs. By its delay, the Council was subsidizing the heating of rent-

*Continued*

Continued from Page 1  
 controlled housing with no consideration for the occupant's ability to pay.

Rent control, of course, is a massive blind subsidy, making no distinction whatever among the 850,000 families who benefit from it. The \$45,000-a-year family on Manhattan's West Side may pay as little as one-eighth its income for shelter, but it is treated the same as the \$7,000-a-year family in Brooklyn that is paying one-third of its income for a rent-controlled apartment.

Building abandonment, tax arrears and deferred maintenance are the well-documented results of rent control, a subsidy that has made it impossible for rental income to keep pace with mounting costs.

The pernicious results of rent control can be curbed only by a far greater tenant assumption of actual housing costs. Rent increases must be adapted to the tenant's ability to pay, using an income-percentage formula for tenants to claim a hardship exemption. When an increase pushes the rent beyond a certain percentage of total income, the landlord should be allowed to deduct the uncollectible rent from his property tax.

The point is that while some tenants will still have to be subsidized, we will know that they need it, which is not the case now.

The problem of the blind subsidy also arises in new or recently completed public-sector housing, much of which is in great financial stress. About 70 per cent of the city Mitchell-Lama housing is in tax arrears or mortgage default. The income problem is like that of rent-controlled housing—the tenants are unable or unwilling to pay enough so that their buildings can meet expenses. Co-op City, the 15,000-unit project in the Bronx, is also in a financial bind.

One response to these problems is a series of bills in Albany under which the state would provide a subsidy for some of the troubled projects, including, for example, Roch-

dale Village and Co-op City.

Should the state bail out its troubled housing investments in New York? On the basis of New York's credit standing alone, the answer is yes. But before tax money is diverted to shore up recently completed public-sector housing, the public has the right to know the difference between what project tenants can afford and what the project requires to meet its obligations.

One possible method is a means test. Residents in public-sector projects could be spared rent or carrying-charge increases if the increases would push their housing costs beyond an agreed-upon percentage of income.

In other words, before residents in public-sector projects are further subsidized, they must demonstrate economic need as well as political clout.

We have, after all, insisted for some time that families of low or moderate income pay a minimum percentage of that income to live in public housing or federally assisted housing. An agreement to pay as much as 25 per cent of income is also the precondition for families to benefit from the new Federal Section 8 housing subsidy program. The severity of the housing crisis makes it more than appropriate for families of middle income to lay out similar percentages for their housing subsidies.

In the midst of the current gloom about New York's economic condition, we tend to ignore two important lessons of history. The first is that the city has faced and overcome far worse problems than it has now. At the turn of the century, when housing was in far more wretched shape than it is now, we subsidized no one. Today we're trying to subsidize virtually everyone.

The second lesson comes from an 80-year-old show-biz man in the now defunct Grand Central Barber Shop. This Italian immigrant, asked what the American experience meant to him, replied: "There's no free lunch."

CIVIL COURT OF THE CITY OF NEW YORK  
COUNTY OF NEW YORK

HOUSING AND DEVELOPMENT ADMINISTRATION  
OF THE CITY OF NEW YORK,

HP 186/1974

Plaintiff,

— against —

COMMUNITY HOUSING IMPROVEMENT  
PROGRAM, INC., SEYMOUR ZUCKERMAN,  
WILLIAM MOSES, SHELDON C. KATZ,  
SANFORD SIROLNICK, JOSEPH SIROLNICK,  
PHILIP SIRONICK, LEONARD WEINTRAUB,  
LAWRENCE GOLD, SHELDON REALTY CORP.,  
SARI REALTY CO., WAYPARK REALTY CORP.,  
J & D REALTY CORP., DAVID REALTY CORP.,  
SANDY SIROLNICK REALTY CORP., BENSON  
REALTY CORP., SEMINOLE REALTY CO.,  
HICKLEY REALTY CORP., EXCEL REALTY,  
MORRIS WEINTRAUB ASSOC., MAYFLOWER  
REALTY CO., WEINTRAUB ASSOC.,

DECISION

SEPTEMBER 9, 1975

Defendants.

----- X

Before:

HONORABLE BERNARD KLIEGER,

Judge.

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Plaintiff New York City Housing and Development Administration (hereafter "HDA") is a superagency of the City of New York, with responsibility for enforcement of housing standards set by state and local laws and regulations.

Defendant Community Housing Improvement Program, Inc. (hereafter "CHIP") is a New York membership corporation composed of owners of real property in New York City. The other defendants are officers and members of CHIP's Board of Directors, and owners of real property.

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HDA commenced this proceeding to enjoin defendants from a planned shutdown of boilers for "maintenance" purposes, to take place December 5, 1974. A temporary restraining order was granted by this Court and has been continued until this time. Defendants have agreed not to promote such a shutdown, and this Court finds that the proposed action was organized by CHIP to dramatize certain housing issues not directly related to boiler maintenance. To protect the public, this Court now grants HDA's application for a permanent injunction.

A hearing on December 5 was adjourned to December 17, 1974, to afford CHIP the opportunity to raise related issues, and there have been a number of subsequent adjournments. Defendants answered on December 9 and pleaded two counterclaims. One counterclaim sought \$1 million for abuse of process. Plaintiff moved to dismiss this counterclaim or for a more definite statement. Plaintiff's motion to dismiss that counterclaim is now granted.

The other counterclaim of that date sought \$750 million on the ground that HDA had engaged in conduct calculated to destroy property. HDA moved to dismiss that counterclaim, or for a more definite statement. This counterclaim was not pursued at the hearings, and HDA's motion to dismiss is granted.

CHIP added a third counterclaim on December 17, 1974, and asked the Court to order a "pass-along" of increased fuel costs to tenants in rent-controlled apartments. HDA again moved to dismiss. There was general agreement, and the Court took judicial notice of the fact, that fuel costs had increased enormously in the previous 18 months and added a tremendous burden to already beleaguered property owners. However, the Court believes that alleviation of that burden is primarily a legislative matter and now grants the motion to dismiss this counter-

claim. It notes that a fuel cost "pass-along" was enacted as Local Law No. 27 of 1975, having been adopted by the City Council on May 9, and approved by the Mayor on June 2, 1975.

After prior notice to all parties, the Court utilized the provisions of New York City Civil Court Act, section 110(c) and on January 28, 1975, ordered that hearings be held in search of "remedies, programs, procedures or sanctions authorized by law" which might better achieve compliance with required housing standards. HDA then brought a proceeding to prohibit and enjoin the Court from holding such hearings, Joy v. Klieger, Supreme Court, Kings County, Index No. 1658/75. An order to show cause was granted by Hon. Frank Composto on January 27, 1975. After a hearing, Hon. Irving P. Kartell ruled on February 5, 1975, that section 110 (c) authorized the proposed utilization of Civil Court Act § 110(c) and denied HDA's application.

Hearings were held, expert witnesses testified and were cross-examined, the Court visited various buildings in the City and studied reports by governmental agencies and knowledgeable individuals. The Court extends its thanks to the officials, professors, representatives of organizations, property owners, and others who came forward to assist the Court in its deliberations, and to the attorneys for both parties who participated in the effort.

At the final argument on March 19, 1975, CHIP moved to conform the pleadings to the proof, to include the claim that the rent control and rent stabilization laws violated due process and equal protection provisions of the Constitutions of the United States and New York State. HDA opposed this motion.

Plaintiff will neither be harmed nor impeded by the granting of a motion to permit the defendants to plead the unconstitutional administration of the laws. Access to the courts is meaningless if constitutional issues are prohibited to parties by the recognition of highly technical objections. It is the policy of the courts to permit a party to amend his pleadings in good faith to raise and have determined all questions affecting his rights, Miller v. City of Philadelphia, 113 App. Div. 92, 99 NYS 93; Washington Life Ins. Co. v. Scott, 119 App. Div. 847, 104 NYS 898.

The New York City Civil Court may entertain any defense to a cause of action or claim (New York City Civil Court Act, section 90 including the defense of unconstitutionality of the act or ordinance under which plaintiff is proceeding (Cf. Lincoln Bldg. Assoc. v. Barr) 1 Misc. 2d 560, 149 NYS 2d 460, affd, 1 NY 2d 413).

Various provisions of the applicable rent control and rent stabilization laws have already been held constitutional by the Court of Appeals, 8200 Realty Corp. v. Lindsay, 27 NY 2d 124, 313 NYS 2d 733 (1970); Hartley Holding Corp. v. Gabel, 13 NY 2d 306, 247 NYS 2d 97 (1963); Plaza Mgt. Co. v. City Rent Agency, 25 NY 2d 630, 306, NYS 2d 11 (1969), and this Court will not consider those matters anew.

But administration of these laws is a separate matter.

The United States Supreme Court held in the case of Boddie v. Connecticut, 401 US. 371, 379, 28 L. Ed 2nd 113, 91 S CT 780 (1971):

"Our cases further establish that a statute or a rule may be held constitutionally invalid as applied when it operates to deprive an individual of a protected right although its general validity as a measure enacted in the legitimate exercise of state power is beyond question." (Emphasis ours.)

Where a party claims that a statute is unconstitutional as applied, it is the function of the courts to grant him the opportunity to be heard. For, as Mr. Justice Douglas said, dissenting in part in Lindsay v. Normet, 405 US 56, 84, 31 L.Ed. 2d 36, 57, 92 S.Ct. 862:

" . . . due process entails the right 'to sue and defend in the courts' a right we have described as 'the alternative to force' in an organized society."

A party is deemed to have waived his right to have a statute declared unconstitutional unless the question is raised at the trial in some manner (Dodge v. Cornelius, 168 NY 242). it may be raised by objection, motion, or exception, and certainly by answer (Rule 3211, CPLR; Massachusetts National Bank v. Shinn, 163 NY 360; People ex.rel. Bush v. Houghton, 182 NY 301).

Accordingly, the motion by defendants to conform the pleadings is granted, to the extent that the administration of the City's rent control and rent stabilization laws will be considered.

It is clear that the existence at the same time of both a rent stabilization law and a rent control law creates confusion for tenants, landlords and public officials, and that these difficulties are confounded by the 1971 Vacancy Decontrol Law, the 1974 Emergency Tenants Protection Act, and many other laws. There is little to be said for confusion. Further, chaos in administering a law may make it unconstitutional.

II

Discussions of housing conditions and standards in New York City invariably lead to assertions that there is a "housing crisis". Yet, the "crisis" is quite subjective. If the question is asked "Is there a housing crisis?" most people will answer affirmatively; but on any agenda of individual problems, or even New York City problems, housing seems to be far down the list. The mass media consider the "housing crisis" of the same genre as the "education crisis", the "health crisis", the "transportation crisis", etc. It is worth noting that since the recent burgeoning of the City's "fiscal crisis", the media have devoted little time and space to the "housing crisis".

To a large extent, present shortages in housing units are the product of the increasing economically-forced abandonment of such units by landlords.

There was testimony that rental property is being abandoned at a rate exceeding 30,000 units a year, but the generally agreed-upon number by housing and planning agencies is 30,000. While cities without rent control may be suffering abandonments, it is clear however that in cities with rent control, housing units are being pushed over the brink and abandoned because of rent control. Housing units are now regressing from "stable," to "deteriorating," to "dilapidated," to "vacant," to "unsafe," to "abandoned," as a result of many factors, the most significant of which is rent control.

Nonpayment of real estate taxes has created several problems. One of these is the loss of badly-needed revenue to the City, with total arrears now estimated at almost \$600 million, and that does not include arrears in water rents and sewer rents. In almost all such cases, revenue from a building is simply not enough to encompass the required payments, and property owners can not pay taxes.

Further, there is a rent gap of some \$750,000,000. a year created by the MBR "system" as administered.

The rent gap is the difference between what landlords actually collect in rents and what is needed to maintain housing units.

This rent gap makes it impossible for landlords to comply with building codes or to pay for the labor for proper maintenance among other things.

The evidence has convinced the Court that rent control had a *different* impact on building owners from 1943 to 1965, from that in the period since 1965. In the earlier years, owners were able to cut some services and maintenance. They had few vacancies. Inflation and interest rates were moderate. But by the 1960's, no services were left to cut, and code compliance was more strictly enforced. All expenses since 1965 have increased far more rapidly, traumatically compounded by the increase in fuel costs from 6¢ a gallon to 35¢ a gallon in 1973-74. The MBR system cannot digest such increased costs, and the irony may be that an MBR-type system may fail in the 1970's, whereas it probably could have worked in the 1960's. By using the word "worked", the Court means that a system of gradual, moderate, rent increases in the 1960's might have helped much real estate; not that the kind of MBR system we have could have been administered better than now.

### III

A discussion of traditional rent control, now embodied in the MBR system, must start with the period before 1970, when it was generally assumed that 1.2 million housing units were covered by traditional rent control. Some units were decontrolled by the 1970 MBR law enacted by the City Council, others by procedures in the traditional rent control law (e.g., for new construction), and many more by the Vacancy Decontrol and Primary Residence laws enacted by the State Legislature in 1971. At present, estimated units under MBR are about 850,000 but the City Department of Rent and Housing Maintenance still keeps reports on all units that were formerly under rent control, even units in two-family houses that were decontrolled twenty years ago. Thus, the record-keeping task itself is an enormous burden.

After New York City was given authority over rent control in 1962, it enacted a basic rent control law and made adjustments periodically, by local law or regulation, as situations changed or new problems emerged. Yet, with all the changes, the system could be administered, not least because most tenants and most landlords could compute what the rent should be, and what increases were appropriate, for a new tenancy or a capital improvement. Requests for hardship increases were being processed, as were requests for rent reductions because of reduced services.

After a series of consultant and task force studies reached the conclusion that rentals had to be increased to protect the economic life of the City's housing, the City administration did not suggest an easy-to-administer program of periodic moderate increases. It attempted to demonstrate that "the brightest and the best" statisticians, economists and "urbanologists" could develop a system that would do the job and be fair to everyone. It was assumed that such a complicated system could in fact be administered. The MBR law was enacted by the City Council in 1970.

Alexander Pope's apt description of what happened next is found in the Dunciad:

"Then rose the seed of Chaos, and of night  
to blot out order and extinguish light"

After a year-long study of the implementation of the MBR system by the New York State (Scott) Commission to Make a Study of the Governmental Operations of New York City, its executive director concluded that the MBR system was an "administrative disaster", and issued a major report cataloging the failures in implementation.

This Court has heard testimony about the MBR system. In general, no-one seems to be happy with it. The City Council tried to repeal it in 1973. The most common criticisms of how MBR operates are as follows:

1. The system contemplated increases tied to moderate cost increases of the 1950's and early 1960's. It does not and cannot reflect the rapid cost increases of the late 1960's and 1970's.
2. In an attempt to enact the 1970 legislation, people who should have known better overpromised the benefits the law would bring to landlords and tenants. When the benefits did not materialize, the subsequent reaction made it less likely for MBR to work.
3. The MBR system might have worked if it had been established as a totally new system with two years for implementation. It could not be implemented on top of an existing system by employees who had to administer an existing law.
4. The MBR system could never have worked because it was too complicated.
5. Everyone assumed that the "technology" (in the broadest sense) was available. In fact, we do not have the technology to work such a complicated system for so many units, within present budgetary parameters.
6. The implementation of MBR was sabotaged by officials in HDA, either by misfeasance or by nonfeasance.

7. The MBR system has never worked, is not working, and can never be made to work.

8. The MBR system is so non-functioning that the courts have to replace it periodically by ordering interim across-the-board rent increases. If this pattern, having existed for five years, will be continued in the future, then we do not need MBR — and it should be replaced by a simpler system for annual increases.

9. Except in special cases, tenant requests for rent reductions for improper landlord behavior or reduced services are not processed in timely fashion.

10. Except in special cases, tenant requests to stop rent increases because of landlord failure to comply with housing codes or to provide essential services, are not processed in a timely manner.

11. Except in rare cases, property owner requests for hardship increases, capital improvements, protests, rent determinations, etc. are not processed in a timely manner.

12. Neither landlords nor tenants can get information in a timely manner as to what the rent for any apartment was, is or will be in the future under MBR.

13. While some people will defend what the MBR system was supposed to do, no-one at the present time will defend the existing system.

Moreover, the administrator of Housing and Development Administration of the City of New York the agency charged with administering the MBR system testified that administering the MBR presented “a very, very, odious administrative problem.” (Starr testimony at hearing.)

The MBR law, as a “system” of regulating rents and housing has been upheld, as was the earlier rent control law. Part of this regulatory system was the potential for additional increases in certain situations. An examination of the administration of this law, however, shows an overly-complicated system of regulation.

The testimony and exhibits at the trial established without contradiction or dissent that the administration of these laws has resulted in wholesale deprivation of property without due process of law, as well as denial of equal protection.

The utter collapse in the administration of these laws has made such procedures to protect property rights of both landlords and tenants as hardship applications and MBR protests a mockery. Literally years of delay and total inaction in processing remedial applications under the

laws has become the rule rather than the exception. A rent gap approximating 750 million dollars has led to a deterioration in housing units, and enforced total abandonment of valuable property on an unprecedented scale. There have not been funds to correct violations. The City of New York is out some 600 million dollars in defaulted real estate taxes at a moment in its financial situation when every dollar is needed. The defendants and those similarly situated have been deprived of property without remedies that constitute the essence of due process and equal protection. Tenants have suffered inconvenience and hardship in many instances. A line of decisions from courts at all levels has indicated growing impatience and concern.

Under all of these circumstances, the conclusion is inescapable that laws that were constitutional ab initio have now become unconstitutional in their administration. Boddie v. Connecticut, supra. An enlightening analogy is to be found in two decisions of our Court of Appeals regarding the constitutionality of a condemnation law. In the first decision the Court of Appeals reversed an Appellate Division holding that a law providing for condemnation of some of the surface transportation lines was unconstitutional. The Court of Appeals held it to be constitutional. The matter reached the Court of Appeals again some years later when the City had failed to make certain payments to the condemnee. At that point, the Court of Appeals warned that although it had originally upheld the constitutionality of the taking, the City's subsequent conduct in administering the ancillary protections to the condemnee was "verging" on making what had been constitutional on its face, unconstitutional as a result of its subsequent administration. In Re Fifth Avenue Coach Lines, Inc., 18 New York 2d 741. And so here, we face a situation where laws originally constitutional have collapsed in follow-through to the point that due process can no longer be said to exist. It is incongruous that rent control laws that were enacted as necessary to cope with a housing crisis, have now in large measure become responsible for the exacerbation of the crisis they were designed to correct.

In summary, the tactic of boiler shut-downs resorted to by defendants to dramatize their problems is legally impermissible and a potential threat to tenants' welfare, and such conduct is permanently enjoined. The plaintiff's motions to dismiss various of the counterclaims are granted in accordance with this opinion. Defendants' motion to amend to conform to the proof and thus raise the constitutional questions dealt with herein is granted. The laws recounted which underlie

the systems of rent control are found to have become unconstitutional as administered, and are declared to be unconstitutional.

Under the circumstances, this Court may grant any type of relief within the broad jurisdiction conferred upon it by Civil Court Act § 110 (c) appropriate to the proof that the aforesaid statutes are unconstitutional. However, the implementation of this decision in so far as it declares said laws to be unconstitutional will be stayed for a period of 60 days to afford an opportunity to plaintiff and other appropriate authorities to present a plan for administering said laws so as to cure the constitutional defects outlined herein. Settle order.

\_\_\_\_\_  
BERNARD KLIEGER

Judge

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 RICHARD A. CRALLO  
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October 22, 1975

Dear Senator Proxmire:

I am an investor in New York City securities and hold a revenue anticipation note which is due on January 12, 1976. On July 1, 1975 the Comptroller of the State of New York issued two audits, one on accounts receivables and the other on real estate taxes for the City of New York. I enclose copies of these reports.

The report on accounts receivables shows that the City of New York has overstated such receivables by at least 324.6 million dollars and has issued revenue anticipation notes against such receivables. It was conceded that the City's Budget and Comptroller representatives knew about this overstatement but did nothing. As an example the City borrowed against a receivable of 121.4 million dollars which consisted of a 36 million dollar claim disallowed by the federal government, a 66.1 million dollar claim in excess of ceiling limitations and state audit disallowance of almost 20 million dollars. The City's own agency classified this receivable as "no good".

The report states "the significant overstatements of receivables also meant that revenue anticipation notes issued by the City and which were stated to be supported by federal and state aid receivables were not so supported."

In sum, over the past two years the City has issued revenue anticipation notes in the amount of 1.275 billion dollars against 404 million dollars in receivables.

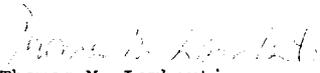
The report on real estate taxes shows that the City of New York has overstated such taxes as of June 30, 1975 by approximately 408 million dollars. It states "the available balance is only \$94 million. Most of these unpaid real estate taxes were

pledged to repay \$380 million of tax anticipation notes issued by the City on June 11, 1975; therefore, the pledged support was largely absent." It is admitted that the City has been aware of such overstatements since 1972.

These reports reveal that a massive public fraud has taken place with the knowledge of elected and appointed public officials. Our Mayor was the Comptroller of the City during the period of these reports. Previously he had been the City's Budget Director. The First Deputy Mayor of the City, James Cavanaugh, who previously worked with Mayor Beame when he was both Comptroller and Budget Director, is reputed to be the father of these borrowing methods.

Your Committee has been taking testimony about this financial crisis. I would ask that these reports be spread on the record and that I be afforded the opportunity to plead the case of the investor, who has so far been ignored. It seems obvious to me that confidence in our system will not be restored until the truth is out and public officials held responsible for their actions. Additionally legislation should be adopted removing the exemption of municipal securities from registration with the Securities and Exchange Commission.

Very truly yours,



Thomas M. Lamberti

TML:es  
Encls.

OFFICE OF THE STATE COMPTROLLER  
DIVISION OF AUDITS AND ACCOUNTS  
REPORT NO. NYC-26-76

REPORT ON NEW YORK CITY'S CENTRAL  
BUDGETARY AND ACCOUNTING SYSTEM  
(INTERIM REPORT NO. 2 - UNCOLLECTED  
REAL ESTATE TAXES)

### MANAGERIAL SUMMARY

#### Background

We are examining into New York City's central budgetary and accounting practices in order to (1) identify shortcomings which have a bearing on the accuracy of the City's financial statements; and (2) develop data leading to the adaptation of the State Comptroller's "Uniform System of Accounts for Cities" to the financial operations of New York City. Our first report (NYC-3-76, dated July 1, 1975) concerned the validity of amounts recorded as due from the State and Federal governments. This second report deals with the collectibility of unpaid real estate taxes due the City, as well as the City's procedures and practices in establishing the assessment amounts which form the basis of the real estate tax rate.

The City Charter requires the City's expense budget to be balanced by the real estate tax levy. To help finance the 1974-75 expense budget of \$11.1 billion, the real estate tax levy amounted to \$2.9 billion. The City's budgeting and financial procedures make no provision for real estate taxes which are not expected to be collected during the tax year, nor do they provide for tax cancellations, abatements or other downward revisions to be subtracted from the gross tax levy. These amounts, when netted against collections of prior year real estate taxes, resulted in a cash flow deficit of \$232 million for the fiscal year ended June 30, 1975. This was critical because the City does not have any reserves to cover such deficits.

The City's records also show a decreasing trend in the collection of real estate taxes in the year of levy. The collection rate of 95 percent in 1969-70 dropped to 90.4 percent in 1974-75. The cumulative uncollected taxes at year-end were two and one-half times higher - \$502.3 million at June 30, 1975 compared with \$204.9 million at June 30, 1970. This condition further aggravated the City's cash flow situation.

#### Major Observations and Conclusions

The City's budgetary practices result in an inflated estimate of real estate taxes that it can reasonably expect to collect to balance the annual expense budget. Unless expenditures are reduced to make up

the shortfall, the City's budget is automatically out of balance; borrowings thus become necessary to meet the cash flow deficiency.

We estimate that the \$502 million of real estate taxes receivable on the City's books at June 30, 1975 are overstated by approximately \$408 million; thus, the available balance is only \$94 million. Most of these unpaid real estate taxes were pledged to repay \$380 million of tax anticipation notes issued by the City on June 11, 1975; therefore, the pledged support was largely absent.

There are two major causes for the tax shortfall:

1. The City included significant amounts of property on its tax rolls which were not subject to real estate taxes or for which taxes would not be collected.

2. The City made no provisions for the increasing volume of cancellations and abatements, and for the inability to collect from defaulting taxpayers.

Our analysis of the uncollected real estate taxes at June 30, 1975 follows:

Total Uncollected real estate taxes	\$502.3 million
Less: Specific categories either not collectible or not readily available-	
Publicly-owned property	\$126.6
Diplomatic property	4.7
Mitchell-Lama property	53.0
In rem property (pending foreclosure)	54.4
Penn Central property (bankrupt corporation)	<u>43.9</u>
	<u>282.6 million</u>
	\$219.7 million
Less: Provision for estimated nonpayment of other taxes	<u>125.7 million</u>
Estimated available amount	<u>\$ 94.0 million</u>

The City's Finance Administration had prepared certain analyses of real estate taxes receivable as of June 30, 1972 and June 30, 1974. Although we were told that these analyses were prepared for other purposes, they showed an alarming growth not only in uncollected taxes, but also in the amounts of real estate taxes due from publicly-owned properties - primarily the City itself (\$59 million out of \$283 million at June 30, 1972, and \$150 million out of \$409 million at June 30, 1974).

The inclusion of publicly-owned properties on the tax rolls resulted in the City assessing significant amounts of real estate taxes which could not possibly be collected - at a rate of about \$36 million a year, leading to an accumulation of \$126.6 million in uncollectible taxes at June 30, 1975. Included in the 18,000 parcels in this category were vacant land, City-occupied office buildings, an urban renewal land site, Carnegie Hall and even a public park and high school. This practice would continue until exemption certificates were processed; but, under present City procedures, exemption certificates are not processed timely.

We found similar delays in reducing the tax rolls for diplomatic properties and tax abatements on Mitchell-Lama properties. For example, the City's records showed \$41.4 million due from Co-Op City (a Mitchell-Lama property), when the amount should actually have been \$1.8 million because of tax abatements authorized under shelter rent exemptions. Diplomatic properties were carried on the rolls unless the owner government initiated tax exemption requests. However, these governments took very little action because they could not be required to pay the taxes in any event. (In this connection, we were told of efforts by the Finance Administration and the City Commission on the United Nations to secure their cooperation.)

Another tax loss results from tax cancellations (write-offs of prior year taxes) which were increasing each year. For the last five years, cancellations totaled \$291 million. However, adequate provision for these reductions were not made in the budget.

The inclusion of these inflated tax levies on the rolls served to understate the tax rate, increase the City's overall debt limit, permit borrowing against inflated receivables, and, of course, permit the City's budget to appear in balance when it was actually out of balance. There did not appear to have been any high level discussions of these facts by City officials, or aggressive action to correct the situation; for example, by compensating for these practices when preparing the City's budget or borrowing on tax anticipation notes. The City needs to overhaul its real estate tax accounting, budgeting and reporting systems to preclude further distortion of its financial status and to make available accurate fiscal information on which to base decisions. Among other things, the City should:

- . Analyze uncollected real estate taxes at June 30, 1975, write off clearly uncollectible amounts, and establish reserves against amounts partially collectible or not readily available.

- . Remove exempt properties from the tax rolls.

. Establish an adequate reserve for uncollectible real estate taxes in future budgets, in accordance with the requirements of the State Comptroller's Uniform System of Accounts.

. Ensure that TAN's issued in the future are adequately secured by collectible real estate taxes.

AUDIT REPORT ON  
REVIEW OF NEW YORK CITY'S  
CENTRAL BUDGETARY AND ACCOUNTING PRACTICES  
INTERIM REPORT NO. 2 - UNCOLLECTED REAL ESTATE TAXES

Office of the State Comptroller  
Division of Audits and Accounts  
Report No. NYC-26-76

AUDIT REPORT ON  
REVIEW OF NEW YORK CITY'S  
CENTRAL BUDGETARY AND ACCOUNTING PRACTICES  
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AUDIT REPORT ON  
 REVIEW OF NEW YORK CITY'S  
 CENTRAL BUDGETARY AND ACCOUNTING PRACTICES  
 INTERIM REPORT NO. 2 - UNCOLLECTED REAL ESTATE TAXES

A. Introduction

1. Purpose and Scope

We are examining New York City's central budgetary and accounting practices in order to: (a) identify shortcomings in the central budgetary and accounting practices which have a bearing on the accuracy of the financial statements presented by the City; and (b) develop data leading to the adaptation by the City of New York of the "Uniform System of Accounts for Cities" promulgated by the State Comptroller.

Our first report on the City's budgetary and accounting practices (NYC-3-76 issued July 1, 1975) evaluated the validity of Federal and State receivables recorded as applicable to the City's fiscal years ended June 30, 1973 and 1974 and still outstanding as of March 31, 1975.

This second report deals with the procedures used to establish the assessment amounts which form the basis of the real estate tax rate and with the techniques for evaluating the collectibility of unpaid real estate taxes due the City. Most of these unpaid real estate taxes were pledged to repay tax anticipation notes issued by the City. We reviewed the policies and practices relative to the write-off of uncollectible amounts and analyzed the real estate tax records maintained by the City's Department of Tax Collections.

In a previous audit report on the "Operations of the Bureau of City Collections, New York City Department of Tax Collections" (NYC-10-75, issued May 16, 1975), we discussed the rising trend of uncollected real estate taxes and the practices and procedures related to in rem foreclosures.

The audit is being performed in accordance with the State Comptroller's audit responsibilities as set forth in Section 1, Article V of the State Constitution and Article 3 of the General Municipal Law.

2. Background

Section 1515 of the City Charter provides for a matching of estimated receipts against proposed expenditures, and indicates an intent to provide for a balanced budget by fixing a real estate tax rate which

will provide such additional receipts as may be necessary:

"...The council shall deduct the total amount of receipts as estimated by the mayor from the amount of the budget, as fixed for the ensuing fiscal year, and shall cause to be raised by tax on real property such sum as shall be as nearly as possible but not less than, the balance so arrived at, by fixing a tax rate in cents and thousandths of a cent upon each dollar of assessed valuation."

For the year ended June 30, 1975, the City's expense budget of \$11.1 billion was to be financed in part by a \$2.9 billion real estate tax levy. This real estate tax levy was the amount required to balance the budget for the fiscal year. However, the City's budgetary and financial procedures do not include any provision for real estate taxes levied but not collected during the tax year or for cancellations, abatements or other downward revisions. These amounts totaled \$279 million for the year ended June 30, 1975. Collections during the year of prior year real estate taxes amounted to \$47 million, resulting in a cash flow deficit of \$232 million at June 30, 1975, exclusive of any possible cash balance in the City's "Rainy Day" Fund.

The City has two accounts which can be used to cover tax deficits:

. The Tax Deficiency Account, established by Section 127 of the City Charter, is intended to absorb real estate tax cancellations and discounts for prepayment of real estate taxes. This fund had a negative balance of \$129.8 million at June 30, 1975, based on our computation.

. The Tax Appropriation Reserve Fund and General Fund Stabilization Reserve Fund, known as the "Rainy Day Fund", was established by Section 128 of the City Charter. Its purpose was to help reduce any deficit in General Fund collections, for internal borrowing in lieu of issuing tax or revenue anticipation notes, and to reduce subsequent year taxes if the Fund balance were to exceed a stipulated level. Thus, the intent was to build up in "good" years an amount which could be drawn on if revenue shortfalls were to occur in "bad" years. The City has waived appropriations to the fund for seven consecutive years because of budgetary problems; the cash balance at January 1, 1975 was \$1.5 million according to the City Comptroller's report.

(These two accounts are discussed in greater detail later in this report.)

City records show a downward trend in the collectibility of real estate taxes in the year of levy. The annual collection rate over the past six years went from 95 percent in 1969-70 to 90.4 percent in

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1974-75. The uncollected balances of real estate taxes at the end of 1974-75 were two and one-half times the balance for 1969-70, as shown in the following table:

Annual Balances of Real Estate Taxes

	Real Estate Tax Levies (in millions)	Percent of Tax Levies Collected in Year of Tax Levy**	Uncollected Taxes	
			Pertaining to Year of Tax Levy (in millions)	Cumulative*
1974-75	\$2,897.5	90.4	\$207.3	\$502.3
1973-74	2,657.3	92.8	148.6	408.5
1972-73	2,468.7	93.8	122.0	337.5
1971-72	2,204.6	94.1	114.1	282.8
1970-71	2,089.6	94.3	101.0	241.9
1969-70	1,901.5	95.0	80.4	204.9

\*Cumulative due after allowing for collections, discounts, and other deductions. These amounts include taxes outstanding for over five years which have been transferred to the "Rainy Day Fund" as receivables.

\*\*The City does not develop the eventual collectibility rate for each tax year.

3. Discussion of Audit Results

Most of our audit observations were discussed with representatives of the Finance Administration during the course of our review and upon its conclusion. In addition, draft copies of this report were furnished to officials of the City Bureau of the Budget, the City Finance Administration and the City Comptroller with a request for comments. Such replies as were received were considered in the preparation of the final report.

*Office of the State Comptroller  
Division of Audits and Accounts*

Report Filed: August 4, 1975

ARTHUR LEVITT  
STATE COMPTROLLER

B. Uncollectible Real Estate Taxes

We concluded that the total amount of real estate taxes receivable on the City's books as of June 30, 1975<sup>(1)</sup> exceeded the probable currently realizable amount by about \$408.3 million, as follows:

Balance Due at June 30, 1975	\$502.3 million
Estimated Collectible Balance	<u>94.0 million</u>
Uncollectible or Not Readily Available	<u>\$408.3 million</u>

The City's budgetary and accounting practices result in an inflated estimate of real estate taxes to be collected to balance the annual expense budget, and do not make adequate provision for taxes that will not be collected. The result has been that budgeted real estate tax amounts have not been realized; for the most part, the revenue shortfall has been met by continued borrowing.

This cumulative revenue shortfall cannot be cushioned by the Tax Deficiency Account which had a negative balance at June 30, 1975 or the Rainy Day Fund with a cash balance of only \$1.5 million and mortgages receivable of \$7.4 million at January 1, 1975.

Two major causes for this shortfall are: (1) the City included properties in its tax rolls which were not subject to real estate taxes or for which taxes would not be collected, and (2) there has been insufficient provision for the increasing volume of defaulting taxpayers and tax cancellations and remissions. In a prosperous economy, the resale revenues from the defaulted property would be expected to cover the taxes due from such properties; current City experience does not show sufficient revenues from this source.

Our analysis of the taxes due at June 30, 1975 shows that, of \$502.3 million outstanding, \$282.6 million pertaining to specific property categories was either not collectible or not likely to be collected in the near future. We also estimated, based on collection experience statistics for prior years, that an additional \$125.7 million is uncollectible. Therefore, out of a balance due of \$502.3 million, it is likely that only \$94 million will be collected and available within a reasonable period. Details of our computation follow.

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Note 1: Based on the City's records as of July 22, 1975, when all postings had not yet been made by the Comptroller. Based upon past experience, postings are generally not completed until December.

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Analysis of Uncollected Real Estate Taxes  
As at June 30, 1975  
(In Millions)

	Total	1974-75	1973-74	1972-73	1971-72	1970-71	Prior Years
<u>Total Uncollected Real Estate Taxes (1)</u>	\$502.3	\$207.3	\$105.0	\$70.8	\$52.9	\$52.0	\$54.3
<u>Less, Uncollectible or Potentially Uncollectible (a)</u>							
Publicly-owned property	126.6	36.0	26.5	16.9	12.4	10.3	20.5
Diplomatic property	4.7	.2	.2	.8	.4	.2	2.9
Mitchell Lama property	53.0	16.5	13.7	11.2	7.9	2.4	1.3
In Rem property (pending foreclosure)	54.4	12.0	12.0	12.0	12.0	6.4	-
Penn Central property (bankrupt corporation)	43.9	9.5	9.0	8.2	7.4	7.8	2.0
Total (2)	282.6	74.2	61.4	49.1	40.1	27.1	30.7
Balance (1-2)	219.7	133.1	43.6	21.7	12.8	4.9	3.6
Less, Provision for possible non-payment (b)	125.7	55.6	31.7	18.1	11.8	4.9	3.6
Estimated Available Amount	\$ 94.0	\$ 77.5	\$ 11.9	\$ 3.6	\$ 1.0	\$ -	\$ -

Notes: (a) Uncollectible amounts were determined from taxes receivable computer printouts as of March 31, 1975 furnished by Finance Administration which we updated to June 30, 1975, using their computer terminal to determine the current status of these properties. They also furnished us with the parcel category breakdown. The aging of the receivables was accomplished on a sampling basis. Uncollectible in-rem amounts were estimated based on the analysis of seven in-rem actions filed by the City, but not, as yet, finalized. There were about 10,000 parcels in this category and the Finance Administration was unable to furnish us with the amount of uncollected taxes applicable to this category. Since no agency information was available, the total amount was distributed evenly over the past four years with the balance in the fifth year.

(b) Represents the additional real estate taxes that we consider uncollectible, based on available statistics of collection experience for the previous six years. The reserves for each fiscal year were adjusted for the required writeoffs of the uncollectible amounts determined by our analysis.

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Similar data concerning the probable uncollectibility of real estate taxes due was available at the Finance Administration. This Office had prepared analyses of uncollected real estate taxes in October 1974 (as of June 30, 1974) and had made a partial analysis of arrears on high valued property only in 1973 (as of June 30, 1972). We were advised by the Finance Administration officials that the 1974 data were used in support of fuel cost passalongs applicable to rent controlled properties for making projections of 1974-75 tax arrears, and for newspaper articles on tax arrears. There was nothing to indicate the extent to which this data had been communicated to responsible budgetary and financial officials outside of that agency. A Finance Administration representative told us that there had been some discussions of these analyses with City Comptroller representatives.

#### 1. Publicly-Owned Property

The 1972 and 1974 analyses showed large cumulative amounts of real estate taxes due from publicly-owned properties (\$59 million of a total of \$283 million at June 30, 1972 and \$105 million of a total of \$409 million at June 30, 1974). Almost all of the publicly-owned properties belonged to the City, but were purportedly not being used for public purposes.<sup>(1)</sup> This practice has the effect of keeping properties on the tax rolls which will not generate actual taxes. In effect, the City is assessing real estate taxes on itself.

The Real Property Tax Law (RPTL), Section 300, states that all real property within the State is subject to taxation "unless exempt therefrom by law". Section 406 of the RPTL exempts municipally owned property only if it is being held for "public use". Since the City cannot collect real estate taxes on non-exempt publicly-owned property, this should be:

- . compensated for when the City prepares its budget,
- . considered when the City analyzes its uncollected real estate taxes, and
- . discounted when the City borrows against its anticipated collections by issuing tax anticipation notes.

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Note 1: It has been held that property owned by a municipal corporation, but not being actually used for public purposes, is not entitled to real estate tax exemption. In order for municipally-owned property to be deemed "held for public use" for the purpose of receiving tax exempt status, the property must be primarily occupied, employed or availed of, by and for the benefit of the municipality at large; this implies a possession, occupation and enjoyment of the property by the municipality. This distinction has no significance in New York City where there is only one real estate taxing authority. In other tax jurisdictions, property not in public use might be taxed by school districts, etc. (See the annotated citations in Note 2, Section 406, Real Property Tax Law, McKinney's Consolidated Laws of New York, Book 49A.)

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Further, in view of the material amounts involved, this situation and its ramifications should be fully disclosed by City officials in all of the statements and reports concerning real estate taxes, estimates and collections.

There were 18,074 parcels included on the City's tax rolls as publicly-owned property not being used for public purposes at March 31, 1975, and representing a cumulative total of \$117.6 million of tax receivables. Each quarter of the tax year generates an additional \$9 million of tax receivables. Thus, as of June 30, 1975, we estimate that the City will have \$126.6 million in this uncollectible category of receivables on its books. (The City had not closed its books for the fiscal year at the time of our audit.)

Examples of such parcels are:

Block and lot	Address/location	Uncollected Real Estate Taxes as at <u>June 30, 1975</u> (in millions)	Owner	Parcel Use
142-1	187 Duane Street Manhattan	\$2.0	City	Site of Manhattan Community College (partially vacant land)
153-1	276-86 Broadway Manhattan	1.2	City	City occupied office building
170-6	346-48 Broadway Manhattan	1.3	City	City occupied office building
346-1	392 Grand Street Manhattan	1.0	City	Land site of Seward Park Urban Renewal
1009-1	881-93 Seventh Ave. Manhattan	2.0	City	Carnegie Hall
4452- 170	Vandalia St. Btwn Penn Ave. and Van Siclen Ave. Brooklyn	1.4	City	Public Park
4142-1	Logan St. Btwn Atlantic Ave. & Dinsmore Pl. Brooklyn		City	Abandoned City Waterworks
16167- 99	100-14 Beach Channel Dr. Queens	2.0	City	High School

All of these parcels had multiple years of real estate taxes unpaid, and we were unable to obtain definitive information from the City Assessor as to why they remained on the City's tax rolls. We were able to ascertain that the City's Tax Commission grants exemptions based on the owner's and/or the parcel's use as defined by law. This procedure is contingent upon the owner filing an application for exemption with the Tax Commission. Barring submission of an application, there is no mechanism for the Finance Administration to exempt the property regardless of who owns the property or for what it is used.

The absence of such a procedure has resulted in levying significant amounts of real estate taxes on properties from which taxes will not be collected. There were 121 parcels in the computer listing of publicly-owned property that had outstanding real estate taxes of \$100,000 or more, with nine of these 121 parcels having balances of \$1 million or more. (We were advised by a Finance Administration official that the City sought an exempt status ruling from the Corporation Counsel ten years ago regarding the Carnegie Hall parcel and resubmitted this request this year.)

We must repeat that the City is generating a built-in real estate tax collection shortfall by continuing the practice of including its own property on the tax rolls. In addition, the City's stated debt limit is artificially inflated as a result of this practice. This occurs because the City's debt limitation is based upon "the average full valuation of taxable real estate" (Article VIII, Sections 4 and 10 of the State Constitution).

## 2. Diplomatic Property

The need for some provision for uncollectible taxes is evident in the City's handling of diplomatic property. The City has on its tax rolls diplomatic properties whose status would be exempt if the proper filing for exemptions were instituted by the owners. Thus, 40 out of a total of 60 diplomatic properties have unpaid real estate taxes, with most of the taxes outstanding for extremely long periods. We found that 15 of the 40 properties had balances of \$100,000 or more. The City's ability to collect these taxes is limited, since diplomatic properties are exempt from in rem foreclosure proceedings.

Our review showed that one of these diplomatic properties had about 10 percent (\$48,509 of a total of \$490,000) of its unpaid real estate tax balance outstanding prior to the diplomatic owner's acquisition. This means the City had a receivable rendered uncollectible in the foreseeable future by a diplomatic purchase, unless recovery can be effected from the prior owner.

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We attempted to determine if the diplomatic owners know of the requirement to file for exempt status. For example, the Soviet Union, one of the larger diplomatic property owners, recently filed for exemption. Finance Administration officials advised us that they requested the City's Commission to the United Nations in July 1973 to act as the City's intermediary to distribute exempt status filing requirements. We were told that the forms were sent at that time to the owners of properties believed to be entitled to exemption and that direct correspondence was initiated with individual consulates (using the City's Commission to the United Nations as intermediary) urging compliance. We were also told that the City stopped applying its earlier policy of not granting the exemption until arrears of the so-called short-rent payments (involving very minor amounts of borough and City-wide assessments), not subject to exemption were received. The officials said that about 10 consulates secured their exemptions as a result of these actions.

### 3. Mitchell-Lama Property

Mitchell-Lama properties, by law, are permitted to apply for shelter rent exemptions which, in effect, are an abatement of real estate taxes. This procedure is lengthy and involves a number of City departments.

Our analysis of the computer listing of real estate tax receivables as at June 30, 1975 showed 185 Mitchell-Lama parcels with \$55.4 million in cumulative unpaid taxes.<sup>(1)</sup> One of these properties was Co-Op City in the Bronx, which accounted for \$41.4 million of the listed unpaid real estate taxes. In view of the significant amount outstanding, we performed a detailed analysis of the parcels involved in Co-Op City and found that all but \$1.8 million, represented overbillings. We were told that the balance of \$39.6 million will eventually be officially cancelled by the City when negotiations are completed.

We were advised by an official of the Real Property Assessment Department of the Finance Administration that the overstated billings for Co-Op City occurred because the tax was determined exclusive of tax abatements authorized under shelter rent exemptions. There were two reasons for the delay in processing: (1) the nonreceipt of certified shelter rents from the Housing and Development Administration for the 1972-73 and 1974-75 tax years; and (2) the pending outcome (delayed due to irreconcilable differences between the development and the City as to which parcels are eligible for shelter rents) of a Tax Commission hearing held on May 21, 1975 which will affect the shelter rents certified for 1970-71, 1971-72 and 1973-74. (Finance Administration officials felt that the Mitchell-Lama law needs to be simplified, that present requirements as to tax abatements and shelter rent exemptions are difficult to implement.)

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Note 1: We estimate that \$2.4 million of this amount is collectible.

Our review of several other Mitchell-Lama projects indicated similar circumstances which also resulted in overbillings. These overbillings represent another example of the lack of communication between City departments. As previously noted, the inclusion of these properties at full assessed valuation in the computation of the City's real estate tax rate results in a tax shortfall and inflated debt ceiling (City's Constitutional limit on borrowing).

#### 4. In Rem Property

In rem properties are those in the process of being foreclosed because of nonpayment of real estate taxes. The City's procedures for accomplishing foreclosures are painfully slow. (This was discussed in our previous report, NYC-40-75. We found in rem filings as far back as November 27, 1973 which were not yet finalized.) Although the city will ultimately realize some revenue from the sale of these properties, the amount that will ultimately be collected is uncertain. Meanwhile, the full amount of the receivables is included in the City's total of uncollected taxes. The City should write off such amounts as soon as the appropriate filings are accomplished and not wait for the actual foreclosure, the procedure now followed by the City.

#### 5. Penn Central Property

The Penn Central Corporation is in reorganization and the collectibility, in the foreseeable future, of outstanding real estate taxes is extremely doubtful. With such significant amounts involved and the fact that normal in rem action cannot be taken, a reserve for uncollectible taxes should be established for the full amount, since the potential revenues do not meet the test of "availability". If any portion of the taxes is ultimately collected, the revenues should be recognized in the year of collection.

The Penn Central owns 147 parcels; 25 of these parcels have the obligation for 98 percent of the \$43.9 million of unpaid real estate taxes. Ten parcels have unpaid real estate taxes of over \$1 million and two of these have balances of over \$5 million.

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\*According to the Penn Central Bankruptcy Court Order No. 1 (Section 9) which complies with Section 77 of the Bankruptcy Act (11 USC Sec. 205) dated June 21, 1970, all persons, firms and corporations are restrained from interfering with, seizing, enforcing liens, etc., or in any manner whatsoever disturbing any portion of the assets, properties or premises, etc., belonging to or in the possession of the Debtor (Penn Central) as owner, lessee or otherwise.

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Examples of such parcels with receivables in excess of \$2 million (all in Manhattan) follow.

Block and Lot	Address and Use	Uncollected Real Estate Taxes as at June 30, 1975 (In millions)	Owner
1280-30	109-35 E. 42nd St. Hotel Commodore	\$5.9	Penn Central Trans. Co.
781-9002	1 Seventh Ave. Privately occupied office building	2.8	Land-Penn Central Building-2 Pennsylvania Plaza Corp.
781-9001	420-58 Eighth Ave. Madison Square Garden	4.2	Land-Penn Central Building-Madison Square Garden Corp.
1304-1	301-19 Park Ave. Waldorf Astoria Hotel	8.8	Land-Penn Central Building-Waldorf Astoria Corp.
1278-20	333-39 Madison Ave. Hotel Biltmore	4.3	Penn Central Trans. Co.
1303-14	520 Lexington Ave. Barclay Hotel	2.2	Penn Central Trans. Co.

All of these parcels had multiple years of unpaid real estate taxes. For two of the properties (2 Pennsylvania Plaza Corp. and Madison Square Garden Corp.), the City has received the taxes due on the improvements (buildings) directly from the corporations. The uncollected taxes shown are those due on the land of these two parcels which is owned by Penn Central.

The three parcels owned by the Penn Central Transportation Company have not paid the outstanding taxes on both the land and the improvements.

We were advised by an official of the Waldorf Astoria Corporation that his corporation was depositing the real estate taxes due on this parcel's improvement payable to Penn Central in an escrow account. Thus, it may be possible for the City to negotiate a similar arrangement with Waldorf Astoria Corporation as exists with the Madison Square Garden and 2 Pennsylvania Plaza properties and collect the real estate taxes directly from the Waldorf Astoria. In the latter case, of the total

\$8.8 million outstanding taxes, \$5.9 million is applicable to the improvements. This negotiation is contingent on the contractual arrangement between Penn Central and the Waldorf Astoria Corp.

Finance Administration officials advised us, in response to our draft report, that special efforts are being made, principally by the City Corporation Counsel's office, to secure payments of Penn Central taxes. They cited a recent law (Section 605, The Rail Reorganization Act Amendments of 1975, Public Law 95-5, effective March 1, 1975) which, they believe, strengthens the City's case for direct payment of taxes from Penn Central lessees. However, the interpretation of this law is under dispute and the Court has not yet ruled on it. In addition, the City believes it is reasonable to anticipate that it will make collections when distributions are made, since taxes have a high priority, and where properties have been sold, the liens have been transferred to the proceeds of the sale. Further, they stated that none of the tax liens have been cancelled by the Court. For these reasons the Finance Administration feels that Penn Central arrears should not be written off as uncollectible. It also was noted that, during the ongoing negotiations, some of the overdue taxes have been collected.

We are not suggesting that the Penn Central arrears be written off. Rather, the arrears should be kept on the books and a bookkeeping entry made establishing a provision for uncollectibility. Such a provision would be fiscally prudent, in that the central records would show the amounts of taxes readily available to meet expenditures; it would also prevent borrowing against taxes that either may never be collected or may not be collected in the foreseeable future.

C. Fixing the Real Estate Tax Rate

Chapter 58, Section 1515 of the City Charter provides both the time and the procedure for fixing each year's real estate tax rate. An important preliminary to this action is the completion of assessment rolls for the year, which is accomplished by the Finance Administration after the Tax Commission conducts hearings to evaluate claims of dissatisfied property owners and applications for exempt status. The time sequence is:

- . Tentative assessment values established on January 25;
- . Tax Commission's hearing period from February 1 to May 25;
- . Determination of final Citywide taxable assessed values as at May 25;
- . Remission actions by the Tax Commission after May 25;
- . City Council fixes tax rate by June 25.

Remissions are reductions in a property's assessed value, granted subsequent to the finalization of the assessment roll on May 25. They can take place from May 25 to June of the following year (13 months), and may result either in a cancellation of taxes (where the tax bill has already been issued) or in the issuance of a revised bill. Remission actions result in an actual real estate tax loss to the City because the tax rate, once set, cannot by law be adjusted.

Reductions in assessed value granted subsequent to May 25 are not reflected in the final taxable assessed values, resulting in a lower tax rate than that needed to balance the budget. For example, in fiscal year 1974-75, the Tax Commission granted \$535.6 million of remissions of assessed values (to May 30, 1975) representing \$39.3 million in taxes. Thus, the tax rate computed for 1974-75 did not include the \$535.6 million reduction in assessed value, and the City lost the \$39.3 million which could have been collected from other taxpayers if it had been deducted in sufficient time to have been included in the rate make-up.

Our review showed that the Finance Administration does not maintain one list of the amounts of remissions granted by tax year. We believe this is a serious internal weakness because, in the absence of such data, management is not aware of the extent and significance of the remissions. Since the tax on these remissions will not be collected, the City should provide for this event by (a) an annual appropriation, or (b) giving consideration to this factor in computing the tax rate.

D. Cancellation of Real Estate Taxes

Tax cancellations represent the removal of real estate tax obligations recorded as uncollected for prior years. The are generated by State Supreme Court orders, Tri-Board rulings (Corporation Counsel, City Comptroller and Tax Commission) or the Tax Commission. For fiscal year 1974-75, \$71.4 million of taxes for this year were cancelled. This amount is considerably higher than the 1973-74 cancellation of \$43.6 million. The amounts of the cancellations have progressively increased and represent a significant revenue loss to the City. For the last five years, cancellations totaled \$291 million, as shown below and as further detailed in the succeeding schedule.

1970-71	\$ 51.8 million
1971-72	45.7 "
1972-73	57.9 "
1973-74	64.0 "
1974-75	<u>71.4</u> "
	<u>\$290.8</u> million

Tax Cancellations

<u>Year Cancelled</u>	<u>1974-75</u>	<u>1973-74</u>	<u>1972-73</u>	<u>1971-72</u>	<u>1970-71</u>	<u>1969-70 and Prior</u>	<u>Totals</u>
1974-75	\$71,399,735	\$20,385,518	\$14,993,565	\$ 8,591,112	\$ 6,893,432	\$ 16,025,311	\$138,288,673
1973-74	-	43,595,020	12,599,981	10,485,519	7,765,678	22,987,858	97,434,056
1972-73	-	-	30,347,728	10,708,876	7,904,601	18,836,171	67,797,376
1971-72	-	-	-	15,902,363	10,079,079	24,218,642	50,200,084
1970-71	-	-	-	-	19,194,570	34,901,612	54,096,182
1969-70 and prior	-	-	-	-	-	15,118,694	15,118,694
Totals	<u>\$71,399,735</u>	<u>\$63,980,538</u>	<u>\$57,941,274</u>	<u>\$45,687,870</u>	<u>\$51,837,360</u>	<u>\$132,088,288</u>	<u>\$422,935,055</u>

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Section 127 of the City Charter states that all cancelled taxes are to be charged to the Tax Deficiency Account and that an amount equal to the net debit balance in the account as of February 1, if any, is to be appropriated in the following year's expense budget. Accordingly, \$29.4 million was included in the 1975-76 budget for this purpose.

Between 1971 and 1975, the amount of taxes cancelled in the year levied has increased almost 400 percent. Over these past five years, it has averaged out at 2.35 percent of the tax levied. These tax cancellations have resulted in a large debit balance in the Tax Deficiency Account of \$129.8 million at June 30, 1975.

Percent of Real Estate Tax Collections to Tax Levy

<u>Tax Year</u>	<u>Tax Levy</u> (In millions)	<u>Taxes Cancelled</u>				<u>Total Percent Cancelled</u>
		<u>In Year of Levy</u>	<u>Percent</u>	<u>Subsequent Years</u> (In millions)	<u>Percent</u>	
1974-75	\$ 2,895.9	\$ 71.4	2.47	n/a	-	2.47
1973-74	2,657.2	43.5	1.63	\$ 20.3	.76	2.39
1972-73	2,468.6	30.3	1.22	27.4	1.10	2.32
1971-72	2,204.5	15.9	.72	29.6	1.34	2.06
1970-71	<u>2,089.6</u>	<u>19.1</u>	.92	<u>32.5</u>	1.51	<u>2.43</u>
	<u>\$12,315.8</u>	<u>\$180.2</u>		<u>\$109.8</u>		<u>2.35</u>

E. Accounting for Real Estate Taxes

Manual records are used by the City Comptroller to record real estate taxes on the City's accounting records. The manual records include a general journal and general ledger, and entries are made monthly and posted to the ledger quarterly on a modified accrual basis. In addition to the manual records, the City Comptroller maintains automated records which serve as the City's fund ledger recording the appropriations, expenditures and appropriation balances for each fund.

At the start of the fiscal year, journal entries are made and recorded in the general ledger to set up the real estate taxes receivable for that year as well as the adopted budget and appropriations. In addition to recording the actual collections, the balance in the taxes receivable account is reduced by remission orders and cancellations. Separate accounts are not maintained for each year's taxes receivable.

Tax cancellations (including remission orders) are charged to and recorded in the Tax Deficiency Account (TDA). Another charge to the TDA is for discounts to taxpayers for prepayment of real estate taxes. Credits to the account include collection of prior year delinquent real estate taxes previously charged to this account, unspent balances from prior expense budgets, proceeds from the sale of property taken over by in rem actions, and gains on the extension of the tax rate to the nearest hundredth of a cent.

On July 1, 1974 the Tax Deficiency Account, which is maintained on a fiscal year basis, had a negative balance of \$49,279,790; that is, expenses charged to the account were greater than the income. Activity for fiscal year 1975 included: tax cancellations, abatements and cash discounts amounting to \$71,399,735; and cancellations of prior years taxes amounting to \$66,809,303. Thus, in total, \$138,288,679 was charged during the year to the TDA. Credits to the account amounted to \$57.8 million. Using this data, obtained from the City Comptroller's office, we determined that the TDA will have a negative balance of \$129.8 million as at June 30, 1975, as detailed in the following schedule.

Analysis of Tax Deficiency Account Balance  
as at June 30, 1975

	<u>In millions</u>
Debit balance, July 1, 1974	\$ 49.3 (1)
Add: Credits during year -	
Gains in extensions-tax levy 1974-75	\$ .3 (1)
Sales of in rem property	1.2 (1)
Redemption of Tax Anticipation Notes from unused balances of prior year appropriations	<u>56.3 (1) (2)</u>
Total Credits	<u>57.8</u>
	\$ 8.5
Less: Charges during year -	
Cancellations and remission of taxes, and discounts allowed for prepayment of taxes	<u>138.3 (3)</u>
Debit balance, June 30, 1975	<u>\$129.8 (4)</u>

## Notes:

(1) Actual amounts per City Comptroller's books

(2) Analysis: <u>Year</u>	<u>Unused Balance</u> (Per City Comptroller)
1974-75	\$54,627,388
1973-74	1,012,399
1972-73	641,833
1971-72	<u>18,380</u>
Total	<u>\$56,300,000</u>

(3) Per Finance Administration reports--basis for the City Comptroller's entry

(4) The June 30, 1975 balance of this account is more than \$80 million higher than this account's balance as at June 30, 1974, indicating that the 1976-77 expense budget will probably require an appropriation of more than \$100 million to return the account to zero as required by the City Charter. (However, because of City Charter limitations, a maximum of about \$36 million may be appropriated to this account at this time.)

The City Charter (Section 113) requires the City Comptroller to report on the status of and the required appropriations to be made, if any, to the Tax Deficiency Account and the Tax Appropriation and General Fund Stabilizations Reserve Fund. This report is required to be prepared each February on a calendar year basis and presented to the Mayor, City Council and Board of Estimate. At the end of calendar year 1974 the TDA had a debit balance of \$29.4 million. We verified that this amount was provided for in the 1975-76 expense budget, as required, to return the account to a zero balance.

Section 128(b) of the Charter requires an annual appropriation to be made in the expense budget to bring the balance in the reserve fund up to an amount equal to 30 percent of the current year's tax levy. However, the total amount appropriated for both the TDA and the Rainy Day Fund cannot exceed 2 percent of the current year's tax levy, exclusive of debt service. Fiscal 1967-68 was the last year for which an appropriation was made in the expense budget for the Rainy Day Fund.

Transfers and borrowed amounts are required to be repaid to the reserve fund according to the schedule set forth in the Charter; that is, amounts are to be repaid in equal amounts in not less than three of the six following expense budgets. Between July 1, 1969 and June 30, 1974 transfers totaled \$82.2 million, none of which has been repaid, resulting in a cash balance of only \$1.5 million at the close of fiscal 1974. (There were \$6.4 million of transfers prior to July 1, 1969.) The fund's only other realizable asset is \$7.4 million in mortgages which will be collected in small amounts over a period of years.

Each year since 1969, legislation has been approved by the City Council to suspend the necessary appropriations and repayments to the Rainy Day Fund. This practice continued into 1975-76 by the adoption of Local Law 34 of 1975. The amount which should have been appropriated, per the City Comptroller, in the 1975-76 budget is presented below.

<u>Required Reserve Fund Appropriation in 1975-76 Expense Budget</u>		
1. Current year's tax levy within the 2½ percent tax limitation	<u>\$1,707,213,338</u>	
2 percent of above (maximum appropriation)	\$34,144,267	
less: Amount required for Tax Deficiency Account	<u>29,445,905</u>	
Balance Available for Reserve Fund		\$ 4,698,362
2. Amounts borrowed and transferred, not yet repaid		<u>88,612,576</u>
Total Required Appropriation		<u>\$93,311,038</u>

Tax Anticipation Notes

The City's cash flow situation requires frequent sale of tax and revenue anticipation notes to provide operating funds pending receipt of revenues. The collateral is uncollected real estate taxes for the tax anticipation notes (TAN's) and other receivables for the revenue anticipation notes (RAN's). Since the estimated tax revenue has been overstated, TAN's should not have been issued for the full amounts recorded as receivable.

The City issued \$380 million of TAN's on June 11, 1975 secured by \$448 million of uncollected real estate taxes. We found that real estate taxes that could be reasonably construed as "collectible" or "available" would support less than one-third of these TAN's. According to our analysis, only \$106 million of the \$448 million of uncollected real estate taxes were potentially collectible at June 10, 1975, leaving 72 percent or \$274 million of the TAN's unsupported. (Between June 10 and our later study as of June 30, 1975, a total of \$12 million was collected or cancelled.)

Analysis of Unsecured TAN's  
as of June 10, 1975

<u>Year</u>	<u>Uncollected Taxes, per Comptroller's June 10, 1975 Certification</u> a	<u>Taxes Determined to be Uncollectible by our Analysis</u> b (all amounts in millions)	<u>Reserve for other Uncollectibles, Based on Prior Years Experience</u> c	<u>Maximum Amount of TAN's to be Issued (Differences)</u> d=a-(b+c)	<u>Amount of TAN's Actually Issued</u> e	<u>Amount of Under collateralized TAN's</u> f=e-d
1974-75	\$218.7	\$ 74.2	\$ 55.6	\$ 88.9	\$190.0**	\$101.1
1973-74	105.3	61.4	31.7	12.2	90.0**	77.8
1972-73	70.0	49.1	18.1	2.8	60.0***	57.2
1971-72	54.0	40.1	11.8	2.1	40.0***	37.9
	<u>\$448.0</u>	<u>\$224.8</u>	<u>\$117.2</u>	<u>\$106.0</u>	<u>\$380.0</u>	<u>\$274.0</u>

\*\*Sold to a consortium of banks

\*\*\*Sold to the newly established Municipal Assistance Corporation

The certificates issued by the City Comptroller included a certification as to the amount of real estate taxes uncollected and not cancelled as of June 10, 1975. However, the amount of potentially uncollectible real estate taxes was not determined and deducted from the certified amount.

The pattern of borrowing by the City through the issuance of TAN's over the last three fiscal years indicated a fairly large amount (\$600 million-\$800 million) at the beginning of each fiscal year, a much smaller borrowing (\$90 million-\$115 million) about mid-November, and another borrowing (\$265 million-\$380 million) about mid-June. While the TAN's issued earlier in the fiscal year would be fully supported by collectible tax receivables, the year-end borrowings may not have been fully secured by collectible receivables as shown in the preceding illustration.

G. Conclusion and Recommendations

The City must have reliable financial data on which to make its financial decisions. This report provides strong evidence that the City has not taken into account uncollectible real estate taxes in making its decisions. Practically all the information on these uncollectible receivables was readily available to City officials; however, the Finance Administration did not distribute it and neither the City Comptroller's Office nor the Budget Office requested it.

It is vital that the City overhaul its real estate tax accounting, budgeting and reporting systems to preclude further distortion of the City's financial status and to make available accurate fiscal information on which to base future decisions. We specifically recommend:

1. The City should analyze its uncollected real estate taxes at June 30, 1975 for the purpose of establishing the extent to which they are collectible or uncollectible. A reserve for uncollectible taxes should be established in accordance with the requirement of the State Comptroller's "Uniform System of Accounts for Cities". The term "uncollectible" should be considered within the context of the availability of funds to meet current expenditures.
2. Appropriate changes should be made to the City Charter to require the establishment of a reserve for uncollectible real estate taxes.
3. Closer liaison should be established among City agencies to assure consideration by the City Budget Office and City Comptroller's Office of all appropriate data in establishing the necessary reserves for uncollectible taxes and in taking other financial actions such as the issuance of TAN's.
4. Uncollectible taxes on publicly-owned and diplomatic properties should be cancelled. Appropriate accounting entries should be made to record the resulting revenue loss as of June 30, 1975.
5. Necessary legislative revisions should be requested to eliminate the inclusion of publicly-owned property not used for public use on the City's real estate tax rolls.
6. The City Comptroller's office should verify the collectibility of real estate tax receivable information used to secure TAN's.
7. Readily available totals by tax years should be maintained on the amounts of tax remissions and cancellations granted.
8. The City should follow up on the collection potential of the Penn Central properties.

## Comments of New York City Comptroller on Audit Report

The conditions and practices identified in this audit report have their roots in the City's budget making and spending processes. The report properly criticizes the inclusion as revenue in the budget of 100 per cent of real estate taxes to be levied in the fiscal year. This practice, though unrealistic, has been followed for many years and has been one of the known factors in the process by which spending levels have been increased. Since the annual reports of the City Comptroller have for many years documented that 100 per cent of real estate taxes will not be collected in any one fiscal year, some time ago I issued detailed guidelines recommending abandonment of this and related practices in connection with the management of the City's budget.

Unfortunately, the spending levels authorized in recent budgets have been sustained only through maximum borrowing against the revenues on which the budgets have been based. Once the City's budget provided a specified level of expenditures, failure or refusal to carry out the borrowings which alone could sustain the expenditures, would have placed the City in a position where it could not sustain its budgeted obligations.

The State audit report, in short, exposes a fundamental flaw in the City's fiscal operations. But the flaw is in the budgeting process itself, even if it becomes more visible through the borrowing process.

Wherever it lies, however, it is but one of the unsound practices which have allowed the City to inflate its budgets, year after year, and have thus contributed to the current crisis. The provision of a mandatory budget reserve for uncollected taxes, as contained in my plan circulated in June for a restructuring of the City's accounting systems, would remedy this condition.

As provided in applicable sections of the City Charter, the collection of the real estate tax levy, after establishment of a tax rate by legislative action, is the responsibility of the City Collector operating under the Finance Administrator. The City Collector reports to the Comptroller's Office the daily collections of current-year and prior-years' tax levies. These daily reports of collections are entered on the books of the Comptroller.

It is periodically necessary for the City Comptroller to issue Tax Anticipation Notes to finance the operations of the Budget. When such notes are issued, the Comptroller certifies that a given amount of a particular tax levy remains uncollected and uncancelled as of a particular

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date. If the remaining taxes receivable, i.e., those still not collected and not cancelled, are in an amount exceeding Tax Anticipation Notes already outstanding and contemplated to be issued, the law specifically permits the issuance of such notes.

The Tax Deficiency Account accumulates, as debits, the total monthly cancellations as they are reported to the City Comptroller by the Finance Administration. Various items are credited to this account as delineated in Chapter 127 of the City Charter. As of the end of the calendar year the City Comptroller reports publicly, in his February 15th Statutory Report, on the net debit balance in this account, if such exists. This net debit balance must thereafter be eliminated by an appropriation in the next Expense Budget. Such appropriation, however, cannot exceed 2% of that portion of the current tax levy which is within the 2½% tax limitation. Thus, at June 30th of each year, there is usually a debit balance in the Tax Deficiency Account representing both that portion which has been appropriated in the next Expense Budget and the additional cancellations charged to it for the six months since the end of the calendar year.

When an appropriation to the Tax Deficiency Account has been included in the Expense Budget, the total Tax Anticipation Notes issued and outstanding for the fiscal year may not exceed the total taxes outstanding at a given date less the appropriation to the Tax Deficiency Account.

Although these and all other requirements of law have been meticulously followed by the City, the audit report is correct in its bottom-line conclusion that large amounts of uncollectible real estate taxes have accumulated on the City's books and should now be written off. Fortunately, the refunding made available by the Municipal Assistance Corporation has given the City an extraordinary opportunity to accomplish this.

To avoid any recurrence of this situation, I have instituted a mechanism in the audit unit of the Comptroller's Office to verify on a regular basis the collectibility of real estate taxes on which the City budget is predicated and against which the City issues Tax Anticipation Notes.

OFFICE OF THE STATE COMPTROLLER  
DIVISION OF AUDITS AND ACCOUNTS  
REPORT NO. NYC-3-76

REPORT ON NEW YORK CITY'S CENTRAL  
BUDGETARY AND ACCOUNTING SYSTEM  
(INTERIM REPORT NO. 1 - PRIOR YEAR  
ACCOUNTS RECEIVABLE)

MANAGERIAL SUMMARY

Background

We are examining into New York City's central budgetary and accounting practices in order to (1) identify shortcomings which have a bearing on the accuracy of the City's financial statements, and (2) develop data leading to the adaptation of the State Comptroller's "Uniform System of Accounts for Cities" to the financial operations of New York City. This is the first of two reports concerning the validity of amounts recorded as due from the State and Federal governments. Reports on other aspects of the City's finances will be issued as our audit progresses.

Pursuant to Section 1515 of the City Charter, New York City's annual Expense Budget is required to be funded from estimated receipts, with the difference between budgeted expenses and receipts to be made up by real estate taxes. Approximately 38 percent of the City's \$11.1 billion Expense Budget for the year ended June 30, 1975 (or \$4.2 billion) was budgeted as Supplementary Revenues to be received from the State and Federal governments.

A large part of the aid payments made by the State and Federal governments is related to expenditures incurred by the City under specific programs. However, the timing of the expenditures made by the City does not precisely coincide with the payments made by the State and Federal governments to the City. Although some advances are made to the City, the State and Federal payments tend to lag behind the City's expenditures. The lag is caused by a variety of factors, such as statutory requirements concerning payment dates and the timeliness of the filing for reimbursement by the City.

Because of the nature of the payment cycle, the financing of programs by the State and Federal governments would normally result in "accounts receivable" on the City's books. The effect of this procedure is that the City has a built-in need for short term borrowings. Under a disciplined budgetary and accounting system all of the accounts receivable would be collected and converted into cash in a relatively short period of time. Borrowings could then be repaid from the actual

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collections against the accounts receivable. To the extent, however, that the accounts receivable are inflated or not collectible, then the City would have a deficit which must ultimately be paid by means of appropriations.

New York City's accounts receivable from the State and Federal governments at March 31, 1975, according to the City Comptroller's books, included \$290.0 million applicable to the fiscal year ended June 30, 1974 and \$144.2 million applicable to the fiscal year ended June 30, 1973. We compared these amounts with the accounting data on hand in seven of the City's major agencies. We also confirmed these balances with related agencies of the State and Federal governments.

#### Major Observations and Conclusions

The accounts receivable from the State and Federal governments applicable to the years ended June 30, 1974 and June 30, 1973, recorded in the City's central fiscal records as of March 31, 1975, are grossly overstated. We examined \$373.3 million out of \$434.2 million of such receivables, and found them to be overstated by \$324.6 million. Following is a summary of the results of our examination, by department.

	<u>Accounts Receivable</u>		
	<u>Per City</u>	<u>Per</u>	<u>Indicated</u>
	<u>Records</u>	<u>Audit</u>	<u>Overstatements</u>
	<u>(In millions of dollars)</u>		
Board of Education	\$ 58.0	\$26.3	\$ 31.7
Board of Higher Education	2.1	-0-	2.1
Human Resources Administration	31.5	5.2	26.3
Department of Social Services	152.9	-0-	152.9
Charitable Institutions	100.0	-0-	100.0
Health Services Administration	15.6	5.0	10.6
Environmental Protection Administration	13.2	12.2	1.0
Total Receivables Examined	\$373.3	\$46.7	\$324.6
Other Agencies Not Examined	60.9		
Total Accounts Receivable	<u>\$434.2</u>		

The City's internal procedures for recording, maintaining and monitoring State and Federal accounts receivable are inadequate. Therefore, one cannot rely upon the central accounting records and related financial reports to present fairly the status of these receivables. The gross overstatement of accounts receivable means that the City has similarly overstated its prior year revenues. In effect, it also enabled the City to incur expenditures without having other revenue sources; the City did, however, borrow against these overstated receivables. Further, this enabled the City to report better year-end results than it actually experienced.

A part of the problem may result from the diffusion of responsibility for the accuracy of these records. The City Comptroller keeps the City's formal books of account and issues the annual report; the Bureau of the Budget is responsible for determining the accuracy of receivable balances and for initiating any necessary adjustments. (We were told that it was City Comptroller policy to accept whatever adjustments were made by the Budget office.) But since each individual agency is responsible for executing the programs for which State and Federal aid is paid, the agencies probably have the most current information as to the validity of the receivables.

The City's procedures provided for only limited monitoring of these balances:

. The City Comptroller's office sends each City agency a monthly fund statement which includes receivable balances and changes to the balances. City budgetary and accounting personnel stated that, although there was no written requirement, each agency should have verified these statements and reported any inaccuracies to them. City Budget and Comptroller representatives knew that most agencies were not taking such action, but did nothing to obtain current data.

. Four months after the end of a fiscal year, agencies with recorded receivable balances on the central accounts are requested to reconcile the balances on their records with those on the central books and to explain any difference. (The reconciliation can be a complex undertaking, involving many programs covering different years and the accumulation of expenditure data from multiple sources.) Most agencies do not provide a complete reconciliation and some do not respond at all. Complete reconciliations are necessary to correct the central records.

There was insufficient follow-through to assure that known changes were recorded in the Comptroller's central records. Even though some agencies reported that the receivables were inaccurate, appropriate adjustments were not made. In several instances where actual expenditures were below program estimates, the level of anticipated Federal and/or State aid was not correspondingly reduced on the central accounts.

Our audit also showed that the City had included as accounts receivable substantial amounts that were not collectible or where the likelihood of collection was extremely remote - such as claims for reimbursement of disallowed costs, claims in excess of stipulated limitations, and claims that had been rejected but were on appeal. The receivables included one group of items totaling \$121.4 million that the City Department of Social Services had characterized as "no good".

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Among the effects of these overstatements of receivables was that it delayed appropriations to make up the deficits and permitted continued borrowings on account of revenues which would not be realized.

The significant overstatements of receivables also meant that revenue anticipation notes issued by the City and which were stated to be supported by Federal and State aid receivable were not so supported. We also found several instances where even the City's recorded receivables were less than the amount borrowed. This could occur because the City's procedures did not provide for verification that receivable balances at the date of the note sale were at least equal to the amount of notes sold.

The net effect of these budgetary and accounting practices is that the City spent more than it collected or will collect; it therefore has a substantial unreported budget deficit. We estimate that the total deficit for the fiscal years ended June 30, 1973 and June 30, 1974 on account of overstated State and Federal receivables will amount to \$292 million, as shown below.

	<u>Unencumbered Appropriations</u> (a)	<u>Indicated Overstated Receivables</u> (b)	<u>Indicated Deficits</u> (b) - (a)
	(In millions of dollars)		
Fiscal 1973	\$17.6	\$191.5	\$173.9
Fiscal 1974	<u>15.3</u>	<u>133.1</u>	<u>117.8</u>
Total	<u>\$32.9</u>	<u>\$324.6</u>	<u>\$291.7</u>

This amount will ultimately have to be financed from current appropriations.

The City needs to make immediate revisions in its budgetary and accounting practices concerning the recording of revenues and accounts receivable arising out of State and Federal aid. Specifically:

1. All accounts receivable balances pertaining to the fiscal years ended June 30, 1973 and June 30, 1974, which are still on the books as of June 30, 1975, should be examined for collectibility in accordance with generally accepted accounting principles.

2. To the extent that the June 30, 1975 account receivable balances are not "measurable" and "available", as discussed in this report, they should be written off by a charge to an appropriate deficit account.

3. In the future, revenues and accounts receivable should be recorded on the books only to the extent that they are "measurable" and "available" in accordance with generally accepted municipal accounting principles.

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. Individual agencies should be required to reconcile its records with the City Comptroller's central records monthly, and file a positive report attesting to such reconciliation.

. The City Comptroller should periodically confirm the accounts receivable balances shown on his records with the City agencies and with State and Federal funding sources.

. All adjustments to accounts receivable balances should be fully explained and justified by all responsible City offices, including the City Comptroller, the City Budget Director, and the City's operating agencies.

. All accounts receivable should be conservatively stated, with appropriate reserves established if there are doubts as to collectibility.

Borrowings on revenue anticipation notes should require a certification that the stated receivable balances are based upon the City's most current available data.

AUDIT REPORT ON  
REVIEW OF NEW YORK CITY'S  
CENTRAL BUDGETARY AND ACCOUNTING PRACTICES  
INTERIM REPORT NO. 1 - PRIOR YEAR ACCOUNTS RECEIVABLE

Office of the State Comptroller  
Division of Audits and Accounts  
Report No. NYC-3-76

AUDIT REPORT ON  
REVIEW OF NEW YORK CITY'S  
CENTRAL BUDGETARY AND ACCOUNTING PRACTICES  
INTERIM REPORT NO. 1 - PRIOR YEAR ACCOUNTS RECEIVABLE

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AUDIT REPORT ON  
REVIEW OF NEW YORK CITY'S  
CENTRAL BUDGETARY AND ACCOUNTING PRACTICES  
INTERIM REPORT NO. 1 - PRIOR YEAR ACCOUNTS RECEIVABLE

A. Introduction

1. Purpose and Scope

We are making an examination of New York City's central budgetary and accounting practices. The purposes of the examination are: (a) to identify those shortcomings in the central budgetary and accounting practices which have a bearing on the accuracy of the financial statements presented by the City; and (b) to develop data leading to the adaptation to the City of New York of the "Uniform System of Accounts for Cities" promulgated by the State Comptroller.

Among the subjects that we are examining are: the budgetary practices and related accounting practices for recording the City's revenues; the budgetary practices and related accounting practices for recording of expenditures; the City's fund structure and the bearing of the fund structure upon the financial statements issued by the City; the City's practices concerning the issuance of long-term obligations to finance operating expenses; the nature of the City's accounts receivable, one of its more significant recorded assets; and the trends concerning the City's short-term debt.

This report is the first of two concerning the City's accounts receivable. The report deals with the procedures for recording amounts due from the State and Federal governments, as well as the accuracy of the amounts reported as due from those sources for the years ended June 30, 1973 and June 30, 1974, as of December 31, 1974 and March 31, 1975. A subsequent report will be issued concerning the amounts due from the State and Federal governments for the year ended June 30, 1975. Most of these receivables were pledged to repay revenue anticipation notes issued by the City.

Our examination included a comparison of the amounts recorded in the City's central accounting records, maintained by the City Comptroller, with the data contained in the records of seven major City agencies. We also confirmed these balances with related agencies of the State and Federal governments. The City agency balances that we examined were: Human Resources Administration, Social Services Department, Division of Charitable Institutions, Board of Education, Board of Higher Education, Environmental Protection Administration and Health Services Administration.

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We have previously issued two audit reports on the subject matter to be covered during this examination. Both reports will be updated. The reports were:

. "Report on the Debt Structure of the City of New York", (audit report NYC-42-74), issued May 16, 1974. This report discussed the City's practice of identifying current operating expenditures as eligible for debt financing in the capital budget, and reducing the total operating budget by a corresponding amount.

. Report on the "Use of Special Accounts, New York City Fiscal Operations" (audit report NYC-9-73), issued October 31, 1972. This report showed that the City significantly understated its revenues by recording certain revenue items in a category of accounts called "Special Accounts".

The audit is being performed in accordance with the State Comptroller's responsibilities as set forth in Section 1, Article V of the State Constitution, and Article 3 of the General Municipal Law.

## 2. Background

By law, New York City is required to finance its expenditures from current receipts - the balanced budget concept. In formulating the budget, the City must balance the level of services to be provided against the receipts estimated to be available to pay for the services. Thus, the expenditures for services to be provided in any one year should be limited to amounts expected to be received.

A substantial amount of New York City's expenditures is financed through State and Federal aid. The City's Expense Budget, which is financed primarily from real estate taxes, other taxes, and State and Federal aid, was \$11.1 billion for the year ended June 30, 1975. Of this amount, \$4.2 billion or 38 percent was budgeted as Supplementary Revenues to be received from the State and Federal governments. (The budget also includes additional State and Federal aid classified in other categories.)

The timing of the expenditures made by the City under programs financed by the State and Federal governments does not precisely coincide with the payments made to the City by the State and Federal governments. In some instances, the City receives a full advance. In other instances, the City receives a partial advance and is paid the balance of its expenditures upon the filing of a settlement claim. In still other instances, the City is reimbursed periodically (e.g., every three months) after the submission of a claim. If the City files a claim timely, then

reimbursement is relatively prompt; for example, each month the State makes an advance to the City for 80 percent of the State's share of the estimated expenditures under the public assistance program; a settlement of the balance due the City is made within three months after the end of each quarterly period.

Because of the nature of the payment cycle, the financing of programs by the State and Federal governments would normally result in "accounts receivable" on the City's books. (An account receivable represents moneys due the City against valid expenditures made by the City on programs funded by the State and Federal governments.)

Generally accepted budgetary and accounting principles permit municipalities to record revenues to the extent that they are measurable and available. An "available revenue" means that the item is a resource that can be used to finance governmental operations during the year. With regard to City expenditures which may be reimbursable in whole or in part from State and Federal grants - if the expenditure of funds is the prime factor for determining the amount receivable, revenue should be recognized at the time that the City makes the expenditure, subject to statutory or other limitations. Thus, the City may record these items as revenue, even though it has not yet received the cash from the State and Federal governments.

The effect of such spend first-reimbursed later Federal and State aid programs is that the City has a permanent built-in need for short-term borrowings. (The only way that this can be avoided or alleviated is for the State and Federal governments to make earlier payments to the City or for the City to make a special appropriation of normal revenues to finance the working capital need.)

Under a disciplined budgetary and accounting system, all of the accounts receivable would be collected and converted into cash within a relatively short period of time. Borrowing needed to finance the accounts receivable could then be repaid from the actual collections against the accounts receivable. To the extent, however, that the accounts receivable are inflated, then the municipality would have a deficit which must ultimately be paid by means of appropriations.

New York City's accounts receivable balances at December 31, 1974 and March 31, 1975, applicable to the years ended June 30, 1974 and June 30, 1973, according to the books of the City Comptroller were as follows:

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	<u>As at December 31, 1974</u>	<u>As at March 31, 1975</u>
Applicable to the year ended June 30, 1974	\$427.5 million	\$290.0 million
Applicable to the year ended June 30, 1973	\$261.1 million	\$144.2 million

As a starting point for our audit, we examined the receivables applicable to the years ended June 30, 1974 and June 30, 1973. Because of the passage of time (most of the year-end receivables should be collected within 90 days) it is reasonable to assume that the balances in these accounts would be relatively small. Review of the receivables applicable to the year ended June 30, 1975 is in process and will be reported on shortly.

### 3. Discussion of Audit Results

Most of the matters covered in this report were discussed with representatives of the City Bureau of the Budget and the City Comptroller during the course of our review. Such comments as were received have been considered in preparing this report. A draft of this report has also been furnished to those officials. The City Comptroller's comments are attached as Appendix A.

*Office of the State Comptroller  
Division of Audits and Accounts*

Report Filed: July 1, 1975

ARTHUR LEVITT  
STATE COMPTROLLER

B. Accounting for Supplementary Revenues Receivable

Section 1515 of the City Charter provides for a matching of estimated receipts against proposed expenditures, and indicates an intent to provide for a balanced budget by fixing a real estate tax rate which will provide such additional receipts as may be necessary:

"...The council shall deduct the total amount of receipts as estimated by the mayor from the amount of the budget, as fixed for the ensuing fiscal year, and shall cause to be raised by tax on real property such sum as shall be as nearly as possible but not less than, the balance so arrived at, by fixing a tax rate in cents and thousandths of a cent upon each dollar of assessed valuation."

Because the City's cash flow situation, tax and revenue anticipation notes<sup>(1)</sup> are sold in anticipation of the collection of receipts in order to finance expenditures during the year. This kind of short-term debt has more than doubled in the last five years. The percentage of such outstanding notes at March 31, 1970 to the City's 1969-70 expense budget was 16 percent. At March 31, 1975, these notes represented 39 percent of the 1974-75 expense budget. This resulted in continuing and ever-increasing interest costs. The effect on higher interest amounts has been magnified by the sharp rise in short-term interest rates during this period.

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Note 1: Tax anticipation notes (TANs) are issued to meet cash needs pending the collection of real estate taxes (Section 24.00 of the Local Finance Law). The total life of TANs cannot exceed five years. If an appropriation is required to redeem any portion of these notes, the charge is made part of the debt service paid by the expense budget.

Revenue anticipation notes (RANs) are issued for the same purposes as TANs, but other types of anticipated revenues such as State aid and non-property taxes are earmarked for their redemption (Section 25.00 of the Local Finance Law). RANs mature within one year and may be renewed for one additional year.

The City's expense budget is funded by three sources: real estate taxes; general fund revenues; and supplementary revenues.<sup>(1)</sup> Supplementary revenues consist largely of State and Federal aid. For fiscal year 1974-75, the adopted budget showed State and Federal aid of \$4.2 billion out of total expected supplementary revenues of \$4.4 billion. The total expense budget for the year was \$11.1 billion (net).

#### 1. Control of Receivables

The accounts receivable applicable to the years ended June 30, 1974 and June 30, 1973, as recorded on the books of the City Comptroller as of March 31, 1975, are grossly overstated. The City Comptroller's books show accounts receivable in the amount of \$434.2 million for these fiscal years as of March 31, 1975. We reviewed the balances for seven City agencies amounting to \$373.3 million, and found support for only \$48.7 million. Hence, the overstatement of accounts receivable for these years is \$324.6 million. Furthermore, the City's procedures regarding the recording and follow up of accounts receivable need substantial improvement; they were not adequate to ensure that the amounts recorded on the City's fund ledger were accurate and up-to-date.

City agencies include the estimated State and Federal aid as part of their budget estimates. The budget estimates are reviewed and may be adjusted by the City's Bureau of the Budget. The agencies must await publication of the Executive Budget to see if changes are made in their budgets. (The Executive Budget is the Mayor's proposed budget, which is ultimately the adopted budget after review and approval by the City Council, Board of Estimate and the Mayor.)

The budgeted State and Federal aid is then treated as revenues receivable on the central books of account maintained by the City Comptroller. Subsequently, each agency receives monthly fund statements from the City Comptroller's office which include these receivable balances and the credits against the balances. City budgetary and accounting personnel advised us that they expected each agency to systematically compare the amounts reported to them with the agency's own records, and to notify the City Comptroller or the City Bureau of the Budget of any required changes. This was not a formal requirement and few agencies followed this verification practice. City Comptroller and Bureau of the Budget personnel advised us that they were aware that such verifications were not made.

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Note 1: The gross expense budget is also reduced by certain offsets such as funding provided by the Capital Budget.

On or about October 31 of the following fiscal year, the Bureau of the Budget and City Comptroller jointly request City agencies for which receivable balances appear on the central books to reconcile the balances recorded centrally with the agency records, and to explain any differences. Out of 46 agencies for which accounts receivable balances were recorded, only 30 were requested to reconcile their balances with the balances appearing on the City's central books. Furthermore, only 24 agencies responded to those requests.

The reconciliation is a complex task, because the City's central records of these transactions and the records of the individual agencies were not kept in a uniform manner, showing program totals. Some of the agencies maintained only limited memoranda of receivables and did not reconcile receivable amounts with the actual claims for Federal and State aid. The claims should have been reconciled to applicable revenue and appropriation accounts.

For example, until recently HRA had not complied with State requirements for reconciling its claims to applicable revenue and appropriation accounts. Their representatives had contended that such a reconciliation was not possible. In our audit report NYC-62-73 issued April 30, 1974, we demonstrated not only that it was possible (by successfully reconciling two test months), but that it was necessary on a continuous basis. (We found significant errors in the claims, such as duplications amounting to \$3.4 million. Other audit reports had noted even larger errors.)

For the most part, this same kind of detailed analysis has not been undertaken by the City Comptroller's Office, City Budget Office or the various other City agencies. As a result, the validity of amounts shown as due from State and Federal sources and remaining uncollected after a reasonable cutoff time are questionable.

Following is a summary of the extent to which the seven agencies with the largest accounts receivable balances for the 1974 fiscal year made the reconciliation requested by the Bureau of the Budget and the City Comptroller.

	Submitted	
	Incomplete	Did not Submit
	<u>Reconciliation</u>	<u>Reconciliation</u>
Board of Education	X	
Board of Higher Education	X	
Health Services Administration	X	
Environmental Protection Administration	X	
Charitable Institutions		X
Human Resources Administration		X
Social Services	X	

The City's Budget Bureau is responsible for adjusting the accounts receivable balances, based on each agency's reconciliation. The Budget Bureau has been completing the reconciliations for those agencies which did not respond. However, the journal entries initiated by the Budget Bureau to adjust the central record of balances were not supported by written explanations. (At our request, Bureau of the Budget personnel provided explanations for adjustments we questioned during the audit. The adjustments were often based on incomplete data, as discussed later in this report.)

## 2. Other Causes of Error

### a. Failure to Record Decreased Funding Levels

We noted that Federal and State aid towards various City programs was often based on a percentage of total costs. Anticipated Federal and State aid receivables for these programs were based upon an estimated level of City expenditures. However, we found examples (Health Services Administration and Board of Education, for instance) where program expenditures were below budget estimates. This would result in a decrease of Federal and/or State aid, but such decreased aid levels were not reflected in the records during the budget year.

### b. Failure to Follow-Up and Resolve Differences

A picture of the delays in resolving differences between agency and central receivable records, in an instance where the agency responded to the central request for confirmation of receivable balances, was demonstrated by a December 1974 Health Services Administration letter to the City Comptroller's office. It included the following comments:

"N.G. (No Good) Receivables may be explained as follows:

. In my 12/27/73 letter to you,...I estimated that as of 10/31/73, F.Y. 72-73 State Aid Receivable

should reflect a total of \$3,650,000 instead of \$29,235,746, the balance shown by your records. In my letter, I accounted for the difference of \$25,585,746. Subsequently, instead of writing off the full \$25,585,746, your office only wrote off \$10,600,000 for a difference of \$14,985,746.

. In my 12/27/73 letter to you,...I estimated that as of 10/31/73, F.Y. 72-73 Federal Funds Receivable should reflect a total of \$0 - instead of \$6,737,885, the balance shown by your records. In my letter, I accounted for the difference of \$6,737,885. Subsequently, instead of writing off the full \$6,737,885, your office only wrote off \$6,043,489.

. N.G. Receivables (of \$6,938,683) in F.Y. 73-74 may be explained as follows: Actual expenditures will be substantially less than budgeted for the program listed below. Since State aid varies directly with expenditures, I estimate that actual State aid will be less than budgeted by the following amounts, as a result of the reduced expenditures.

Voluntary agency contracts	\$4,334,581
Municipal C.M.H.C.'s	369,976
Prison Mental Health-P.S.	604,326
Bureau of Child Guidance-P.S.	592,100
Other programs	<u>531,597</u>
(Sub) Total	\$6,432,580

. There were deviations between budgeted and actual funding formulas for certain programs:

Voluntary agency contracts - State aid was budgeted at 51.78% of total expenditures. Actual State aid was reimbursed at 51.2%. \$219,097

Fringe benefits for Administration and Prison Mental Health - State aid was budgeted at 50% of expenditures. Actual State aid was reimbursed at 28.4%. \$263,663

Other program deviations	<u>\$ 23,343</u>
(Sub) Total	\$506,103

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Other program deviations	<u>\$ 23,343</u>
(Sub) Total	\$506,103

C. Confirmation of Receivable Balances

Because most revenues from State and Federal aid are collected either as advances or in reimbursement of expenditures made, one would expect that collection of outstanding accounts receivable would not be delayed for extended periods. We attempted to verify the accounts receivable balances applicable to the fiscal years ended June 30, 1973 and 1974, but still on the City Comptroller's books at December 1974 and again at March 31, 1975, for the seven agencies with the largest accounts receivable balances.

Our examination included an analysis of the accounts receivable data as shown on the seven agencies' records. This analysis was compared with the balances on the City Comptroller's records. Our determination of receivables due the City for fiscal year 1973 and 1974, based upon the agency records, was confirmed by telephone with Federal and State funding sources. In addition, we requested the cognizant State and Federal agencies to provide us with written confirmations. As of June 20, 1975, we had received six of the twelve confirmations, which were in agreement with the original oral confirmations.

(In certain instances State and Federal officials were unable to confirm the extent of certain types of aid reimbursement due the City. This usually occurred where the aid category was not subject to Federal limitations on the amount incurred and thus subject to reimbursement, i.e., they were open-ended appropriations.)

Our examination disclosed that the balances were substantially overstated as of both cut-off dates. As of March 31, 1975 the overstatement in outstanding receivables disclosed by our sample audit was \$191.5 million for fiscal year 1973 and \$133.1 million for fiscal 1974, or a total of \$324.6 million for both years.(1)

Following is a summation of the results of our examination, together with a more detailed discussion of the receivables pertaining to the individual City agencies.

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Note 1: These overstatements may increase if subsequent audit of claims made to the Federal and State government for these periods result in disallowances.

Accounts Receivable  
(In millions of dollars)

	<u>Fiscal Year 1973</u>		<u>Fiscal Year 1974</u>	
	<u>As of Dec. 31, 1974</u>	<u>As of March 31, 1975</u>	<u>As of Dec. 31, 1974</u>	<u>As of March 31, 1975</u>
Balance shown on City Comptroller's records for all agencies	<u>\$261.1</u>	<u>\$144.2</u>	<u>\$427.5</u>	<u>\$290.0</u>
City Comptroller balances applicable to the seven agencies we examined	\$298.4	\$195.0	\$245.4	\$178.3
Balances applicable to the seven agencies based on agency data	<u>19.6</u>	<u>3.5</u>	<u>91.3</u>	<u>45.2</u>
Overstatement	<u>\$278.8</u>	<u>\$191.5</u>	<u>\$154.1</u>	<u>\$133.1</u>

Note: For fiscal year 1973, the accounts receivable for the seven agencies whose balances we examined exceeded the total accounts receivable shown on the City Comptroller's records. For the most part, this was due to the receipt of about \$48 million on account of the Health and Hospitals Corporation which was applied to accounts receivable. This amount, however, had not been recorded initially as a receivable.

1. Board of Education

	<u>Balances</u>		
	<u>As Recorded by the City Comptroller</u>	<u>As Adjusted, Based Upon Operating , Agency Data</u>	<u>Required Downward (Upward) Adjustments</u>
	(In thousands of dollars)		
<u>Fiscal Year 1973</u>			
As of December 31, 1974	\$16,064	\$16,649	(\$ 585)
As of March 31, 1975	( 4,362)	1,438	( 5,800)
<u>Fiscal Year 1974</u>			
As of December 31, 1974	\$68,611	\$45,122	\$23,489
As of March 31, 1975	62,434	24,924	37,510

## a. Fiscal Year 1973 Balances

The City collected \$2.2 million of fiscal 1973 receivables during the period January 1 - March 31, 1975; and reduced its receivables by writing off \$18.2 million. Board of Education, State, and Federal officials advised that \$1.4 million was still receivable for fiscal 1973. For the City to record the correct receivable balance as of March 31, 1975, an upward adjustment of \$5.8 million would be required as follows:

State AidUrban Education

Records at the Board of Education disclosed a receivable balance of \$6.1 million. However, officials at the State Education Department advised us that only \$2 million was still available to the Board of Education. In order to reflect the correct balance, the City Comptroller's fund ledger receivable balances should be reduced by \$.8 million.

\$ .8 million

General Aid Textbooks

Board of Education representatives estimated that expenditures less cash received resulted in a receivable balance of \$1.8 million. The City Comptroller's fund ledger, however, showed a negative receivable balance of \$1.5 million. Therefore, an upward adjustment of \$3.3 million is required.

( 3.3 ) million

State Aid Adjustment

( \$2.5 ) million

Federal AidElementary and Secondary Education Act

Board of Education officials expect to receive \$10.9 million for fiscal 1973. The City Comptroller's fund ledger balance for this program shows only \$2.7 million. Thus, an upward adjustment of \$8.2 million is required.

( \$8.2 ) million

Federal Emergency Employment Act

Federal officials advised that New York City had received the contract ceiling on program reimbursement and that additional funds would not be available to the City. The City Comptroller's ledger, however, shows a receivable of \$4.9 million, which should be written off.

\$4.9 million

Total Federal Aid Adjustment (\$3.3) million  
Net Adjustment (\$5.8) million

## b. Fiscal Year 1974 Balances

The City collected \$6.2 million for fiscal 1974 receivables during the January 1 - March 31, 1975 period. The difference of \$37.5 million, as of March 31, 1975, between the City Comptroller's receivable balance and the data we found is accounted for as follows:

State AidUrban Education

The City Comptroller's records showed a balance of \$11.3 million in excess of that of the Board of Education.

\$11.3 million

General Aid and Textbooks

Board of Education records showed that only \$.4 million is still due for fiscal 1974. This would require the City Comptroller to reduce the accounts receivable balance by \$11.3 million.

11.3 million

Total State Aid Adjustment \$22.6 million

Federal Aid

Board of Education and Federal representatives confirmed that the City was owed a lower amount than the balance shown on the City Comptroller's books. The excess amounts were Elementary and Secondary Education Act (\$9.1 million) and the Emergency School Assistance Act (\$.2 million).

\$ 9.3 million

Amounts recorded as receivable under the Federal Emergency Employment Act which were in excess of contractual ceilings.

5.6 million

Total Federal Aid Adjustments \$14.9 million  
Total Adjustments \$37.5 million

2. Board of Higher Education

	Balances		Required Downward (Upward) Adjustments
	As Recorded by the City Comptroller	As Adjusted, Based Upon Operating Agency Data	
(In thousands of dollars)			
<u>Fiscal Year 1973</u>			
As of December 31, 1974	\$12,554	\$ 0	\$12,554
As of March 31, 1975	( 1,300)	0	( 1,300)
<u>Fiscal Year 1974</u>			
As of December 31, 1974	\$36,511	\$3,862	\$32,649
As of March 31, 1975	3,399	0	3,399

## a. Fiscal Year 1973 Balances

The City Comptroller's fund ledger as of December 31, 1974 showed a receivable balance of \$12.6 million. During the period January 1 - March 31, 1975, \$13.9 million was written off, leaving a negative balance of \$1.3 million. Our analysis showed that there were no receivables for this fiscal year.

## b. Fiscal Year 1974 Balances

The City Comptroller's fund ledger at December 31, 1974 showed a receivable balance of \$36.5 million. However, \$14.7 million had already been received in June 1974 and recorded in a suspense account. It was not transferred to the correct account until January 21, 1975. Subsequently, the receivable was further reduced by cash receipts of \$3.9 million and journal entries writing off \$14.5 million, resulted in a receivable balance of \$3.4 million. Although Board of Higher Education representatives believe that \$133,000 of this total is collectible, we were advised that no additional State funds are available for fiscal 1974 because the board of Higher Education has already received the total State-appropriated amount.

3. Human Resources Administration (HRA) (Exclusive of the Department of Social Services and Charitable Institutions)

	Balances		Required Downward (Upward) Adjustments
	As Recorded by the City Comptroller	As Adjusted, Based Upon Operating Agency Data	
(In thousands of dollars)			
<u>Fiscal Year 1973</u>			
As of December 31, 1974	\$13,462	\$ 0	\$13,462
As of March 31, 1975	13,462	0	13,462
<u>Fiscal Year 1974</u>			
As of December 31, 1974	18,162	5,215	12,947
As of March 31, 1975	18,017	5,215	12,802

Our own analysis confirms the conclusion that the foregoing items cannot properly be classified as accounts receivable. We were told that the first item was related to a legal action that the State was bringing against the Federal government. The State is indeed developing data for an administrative hearing in the Federal Department of Health, Education and Welfare to appeal a Federal denial of State plan amendments under Titles IVA and XVI of the Social Security Act. If successful, the State may be able to negotiate a retroactive adjustment for the period October 1971 through June 1972. To the extent that New York City may benefit from this action, it would involve primarily the programs of the Board of Education, Mental Hygiene, Drug Addiction and Health Departments. We are unable to relate the City's comments to this action. In any event, the ultimate outcome of this action is extremely uncertain. At this point, there is no indication whatsoever that the State will be successful; and if it is successful, how much additional funds may be received or when such funds may be received. The item is not shown as a receivable on the State's books, and cannot be classified as a valid receivable on the City's books.

Because the ultimate collectibility of the foregoing items is extremely doubtful, the City Comptroller should adjust his receivable records for fiscal years 1973 and 1974 to zero balances, as indicated below.

Fiscal Year 1972-73

State Aid Adjustment	\$ 60.4 million
Federal Aid Adjustment	<u>72.4 million</u>
Total Adjustments	<u>\$132.8 million</u>

Fiscal Year 1973-74

State Aid Adjustment	\$57.5 million
Federal Aid Adjustment	<u>( 37.4) million</u>
Total Adjustments	<u>\$20.1 million</u>

5. Charitable Institutions

	Balances		Required Downward (Upward) Adjustments
	As Recorded by the City Comptroller	As Adjusted Based Upon Operating Agency Data	
	(In thousands of dollars)		
<u>Fiscal Year 1973</u>			
As of December 31, 1974	\$54,319	\$ 493	\$53,826
As of March 31, 1975	53,826	-	53,826
<u>Fiscal Year 1974</u>			
As of December 31, 1974	66,431	2,571	63,860
As of March 31, 1975	46,184	-	46,184

## a. Fiscal Year 1973

The December 31, 1974 receivable balance in the City's fund ledger was reduced by cash receipts collected during the January 1 - March 31, 1975 period to \$53.8 million. Agency records showed a receivable balance of \$34 million at March 31, 1975. The difference of \$19.8 million was caused by the Comptroller's recording less cash receipts than the agency, resulting in an overstatement of receivables on the Comptroller's records. Our tests indicated that the \$19.8 million was credited against other programs and/or other fiscal years. For example, a portion of the difference was due to the City Comptroller crediting a March 1973 State aid check of \$38.4 million entirely to the Department of Social Services (DSS). DSS' and Charitable Institutions' records indicated distribution of the check as follows; \$27.6 million to DSS; \$5.4 million to Charitable Institutions; and \$5.4 million to the Health and Hospitals Corporation.

## b. Fiscal Year 1974

The City Comptroller's December 31, 1974 receivable balance of \$66.4 million was reduced by cash receipts during the January 1 - March 1975 period of \$2.6 million, and write-offs totaling \$17.6 million, leaving a March 31, 1975 balance of \$46.2 million. Charitable Institution records showed a receivable balance of \$44.4 million at March 31, 1975. The difference in receivable balances was the result of the City Comptroller recording \$1.8 million less in cash receipts than the agency. (Our analysis showed that the difference was probably attributable to the crediting of these receipts to incorrect accounts and/or fiscal years on the City's fund ledger; see discussion in the preceding paragraph.)

## c. Uncollectible Receivables

Agency data showed a receivable balance at March 31, 1975 for the two fiscal years of \$78.4 million; consisting of cash advances made to voluntary hospitals totaling approximately \$49 million and a \$30 million claim disallowed by the Federal government. (Agency records did not show to which fiscal years these two items was attributable.) In any event, neither item can be classified as a valid account receivable.

. Advances made to voluntary hospitals totaling \$49 million do not represent valid receivables. In effect, there are advances made by the City pending the processing of payments to the hospitals. Since the corresponding claims were not recorded as accounts payable, the advances cannot be construed as accounts receivable.

. A representative of the City advised us that the remaining \$30 million in this account involved the legal action discussed in the preceding section on the Department of Social Services. Our comments in that section pertain to this matter as well. The item cannot be considered as a valid account receivable.

Based on our review of the agency's data, the City Comptroller should adjust his receivable balances for fiscal 1973 and 1974 to zero balances as shown below.

Fiscal Year 1972-73

State Aid	\$ .4 million
Federal Aid	53.6 million
Other	( .2 ) million
Total Adjustments	<u>\$53.8 million</u>

Fiscal Year 1973-74

State Aid	\$21.8 million
Federal Aid	24.5 million
Other	( .2 ) million
Total Adjustments	<u>\$46.1 million</u>

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6. Health Services Administration

	<u>Balances</u>		Required Downward (Upward) Adjustments
	As Recorded by the City Comptroller	As Adjusted Based Upon Operating Agency Data	
(In thousands of dollars)			
<u>Fiscal Year 1973</u>			
As of December 31, 1974	\$15,616	0	\$15,616
As of March 31, 1975	887	0	887
<u>Fiscal Year 1974</u>			
As of December 31, 1974	\$36,686	\$12,768	\$23,918
As of March 31, 1975	14,734	5,025	9,709

## a. Fiscal Year 1973 Balances

The City Comptroller's records at December 31, 1974 showed a receivable balance of \$15.6 million. Subsequently, cash receipts of \$.1 million and write-offs by the Comptroller's office reduced the receivable balance to \$.9 million at March 31, 1975.

Health Services Administration (HSA) representatives advised that no additional funds will be received by HSA for fiscal 1973. This was confirmed by State funding office representatives. The balance should be written down to zero with the following adjustments:

Federal Aid	\$1.5 million
Less, State Aid	(.6) million
Total Adjustments	<u>\$.9 million</u>

## b. Fiscal Year 1974 Balances

The City's fund ledger at December 31, 1974 showed a receivable balance of \$36.7 million. Cash receipts of \$10.2 million and adjustment entries reduced the balance to \$14.7 million at March 31, 1975. HSA officials advised, however, that only \$5 million is still receivable on account of the City's fiscal year 1974 expenditures. Therefore, the balance should be adjusted downward by \$9.7 million as shown on the following page.

State AidMental Health

A \$40 million ceiling was imposed by the State Mental Health Department on this category of costs. New York City balances exceeded the ceiling limitation, and accordingly will not be reimbursed.

\$12.6 million

Public Health

The City's fund ledger reflected a negative receivable balance of \$.8 million applicable to public health and gonorrhea control programs. HSA representatives advised, however, that \$1.9 million is still to be received on this program. The City's fund ledger records should be adjusted upward to reflect this receivable balance.

( 2.7) million

Alcoholism Control

No additional funds are expected for this program.

.1 million

Total State Adjustments

\$10.0 million

Federal AidMental Health

(\$ .6) million

Alcoholism Control

These accounts showed negative balances. It appears that the recorded receipts exceeded budgeted receivables. The entries to this account should be reviewed, and the City's fund ledger appropriately adjusted to reflect a zero balance.

( .8) million

Emergency Employment Act

Amounts recorded as receivable were in excess of contractual ceilings.

1.2 million

Public Health

HSA representatives advised that \$1. million was still to be received for the Public Health Program. Receivables as recorded in the fund ledger were understated.

(\$ .4) million

Total Federal Adjustments

(\$ .6) million

Private Funds

The City's fund ledger reported \$.5 million as receivable from private sources. HSA representatives advised that only \$.2 million is collectible.

\$ .3 million

Total Adjustments

\$ 9.7 million

7. Environmental Protection Administration

	<u>Balances</u>		Required Downward (Upward) Adjustments
	As Recorded by the City Comptroller	As Adjusted Based Upon Operating Agency Data	
(In thousands of dollars)			
<u>Fiscal Year 1973</u>			
As of December 31, 1974	\$ 2,201	\$ 2,102	\$ 99
As of March 31, 1975	( 247)	2,102	( 2,349)
<u>Fiscal Year 1974</u>			
As of December 31, 1974	\$29,439	\$20,994	\$8,445
As of March 31, 1975	13,488	10,085	3,403

\*Includes inter-fund receivables of \$8 million

a. Fiscal Year 1973 Balances

The City Comptroller's records at December 31, 1974 showed a receivable balance of \$2.2 million. Subsequent write-offs of \$2.5 million reduced the receivables to a negative balance of \$.3 million at March 31, 1975. Our review showed that the receivable balance should be \$2.1 million, an increase of \$2.4 million. The amounts are all for State aid.

Maintenance of sewage treatment plant..	\$2.3 million
Air pollution control program	-( .2 ) million
	<u>\$2.1 million</u>
Reduction in the City's write-off of sewage treatment State aid	<u>.3 million</u>
Total Adjustment	<u>\$2.4 million</u>

b. Fiscal Year 1974 Balances

The City's records at December 31, 1974 showed a balance of \$29.4 million. Cash receipts of \$7.5 million and write-offs of \$8.4 million reduced the receivable balance to \$13.5 million at March 31, 1975.

Review of available receivable data indicated that the City's receivable balance should be \$10.1 million, or \$3.4 million less, made up of the following adjustments.

State Aid

EPA officials advised that \$2.1 million was due for maintenance of sewage treatment plants. The fund ledger balances reflected only \$1.0 million. (\$1.1) million

Federal Aid

Federal Emergency Employment Act

The City received the contract ceiling on program reimbursement and additional funds will not be available to the City. .5 million

Interfund Transfer (Special Accounts)

The City included in its receivables \$12 million from Special Accounts. City officials advised that only \$8 million of special account funds would be necessary to support EPA's expenditures. \$4.0 million

Total Adjustment \$3.4 million

D. Revenue Anticipation Notes

To meet its cash flow requirements, the City has issued revenue anticipation notes (RANS). RANS are issued either (a) on account of Federal and State receivables or (b) in anticipation of General Fund revenues not yet collected. In addition to its pledge of full faith and credit, the City specifies which revenues are anticipated to support the issuance of the RANS. Thus, the "Notice of Sale" with regard to the RANS shows the estimated amount of State and Federal aid receivable to finance the expense budget, the collections to date against these receivables, and the notes already outstanding. The remainder represents the balance presumably available to support the new borrowing.

Type (b) notes are usually issued during the last quarter of a fiscal year on revenues such as "accrued" water charges and repaid during the first half of the next fiscal year. During fiscal 1974 the City issued \$298 million of these General Fund type notes. Significantly greater amounts of type (a) notes are issued throughout each year for up to a one-year maturity. During fiscal years 1974 and 1975, the City issued \$4.2 billion and \$4.7 billion respectively of type (a) notes.

We found inadequacies in the City's procedures for determining the amount of RANS it could issue in anticipation of State and Federal aid.

1. The anticipated State and/or Federal aid supporting the note issue, as reflected on the City's books of account, was less than the amount of notes issued at the time of sale. Internal procedures did not provide for verification that the receivable balance at the date of the note sale was at least equal to the amount of notes sold.

2. In addition, large amounts of anticipated State and/or Federal aid will not be realized, as discussed in this report.

Several note sales illustrating these conditions are shown in the following table.

Date of		Amount of RANs Issued	Anticipated Aid Receipts (1)		Balance Against Which Notes Might Have Been Issued, Per City Books (3)	Realizable Aid (2)
Issue	Maturity		Amount	State (S) Federal (F)		
(In millions of dollars)						
9-11-73	2-11-74	\$225	\$338.8	1972/3 F	\$ 215.7	\$ 77.3
2-28-74	9-16-74	50	104.5	1973/4 F	7.1	3.2
5-17-74	9-12-74	300	446.6	1973/4 S	293.1	159.1
5-31-74	10-11-74	125	134.8	1972/3 S	128.5	70.7
5-31-74	10-11-74	175	194.1	1972/3 F	183.7	45.3
6-13-74	1-13-75	100	136.6	1973/4 F	2.8	0
6-13-74	1-13-75	50	57.3	1973/4 S	0	0
11-12-74	11-10-75	250	259.5	1973/4 S	185.8	51.8

Group Totals (In millions of dollars)

RANs Issued \$1,275

Anticipated

Aid Receipts \$1,667.2

Aid Anticipated,

per Books of Account

\$1,016.7

Realizable Aid (2)

\$404.2

When the anticipated receipts were insufficient to repay the note holders on the due dates, the City used other revenues. For example, on September 16, 1974 two RANs totaling \$500 million became due. Because anticipated revenues receivable were not realized, the City was compelled to use the proceeds from a following year's issue of RANs to redeem its prior year RANs.

Notes:

- (1) As set forth in notice of note sale.
- (2) As discussed in this report.
- (3) We were told that these amounts were taken from the latest available monthly report of supplementary receivable balances prior to the date of notice of sale.

E. Conclusion and Recommendations

The gross overstatement of accounts receivable, as discussed in this audit report, means that the City has similarly overstated its prior year revenues. In effect, it also enabled the City to incur expenditures without having other revenue sources; the City did, however, borrow against these overstated receivables. Further, this practice enabled the City to report better year-end results than it actually experienced. We estimate that the total supplementary revenue shortfall applicable to fiscal years 1973 and 1974 will amount to \$292 million, as shown below. Ultimately, this shortfall will have to be financed from current appropriations, because the unencumbered appropriation balances for these two fiscal years are not large enough to absorb this write-off.

Following is a summary of the results of our audit, showing the 1973 and 1974 unexpended appropriation balances reported on the City's books as of March 31, 1975, the estimated uncollectible amounts for each of the two fiscal years, and the effect of the indicated receivable write-offs.

1. Summary of Overstated Accounts Receivable

<u>Fiscal 1973 and 1974</u>	<u>Receivables</u>		
	<u>Per City</u>	<u>Indicated</u>	
	<u>Records</u>	<u>Per Audit</u>	<u>Overstatements</u>
		<u>(In millions of dollars)</u>	
Board of Education	\$ 58.0	\$26.3	\$ 31.7
Board of Higher Education	2.1	-0-	2.1
Human Resources Administration	31.5	5.2	26.3
Dept. of Social Services	152.9	-0-	152.9
Charitable Institutions	100.0	-0-	100.0
Health Services Administration	15.6	5.0	10.6
Environmental Protection Administration	13.2	12.2	1.0
Other Agencies, Not Examined by us	60.9	- (1)	- (1)
	<u>\$434.2</u>	<u>\$48.7</u>	<u>\$324.6</u>

2. Computation of Deficit, After Offsetting Overstated Receivables Against Unencumbered Appropriation Balances

	<u>Total</u>	<u>Indicated</u>	<u>Indicated</u>
	<u>Balance of</u>	<u>Overstated</u>	<u>Deficits</u>
	<u>Appropriations</u>	<u>Receivables</u>	<u>(b) - (a)</u>
	<u>(a)</u>	<u>(b)</u>	
	<u>(In millions of dollars)</u>		
Fiscal 1973	\$17.6	\$191.5	\$173.9
Fiscal 1974	<u>15.3</u>	<u>133.1</u>	<u>117.8</u>
Total	<u>\$32.9</u>	<u>\$324.6</u>	<u>\$291.7</u>

Note 1: The City should analyze the validity of those items not examined by us. Such analysis may reveal an even greater amount of uncollectible receivables.

The City's accounting is inadequate and the system of internal controls is ineffective for ensuring the accuracy of its estimated supplementary revenues receivable. As a result, the data in the City's central fiscal and accounting records cannot be relied on for reporting to the Public and for management decisions as to budgetary status, accounts receivable, and borrowings against these receivables.

The following recommendations are made:

1. The City should undertake an immediate analysis of all accounts receivable recorded as due from the State and Federal governments as of June 30, 1975. To the extent that the recorded receivables cannot be characterized as "measurable" and "available", as discussed in this audit report, they should be written off to an appropriate deficit account.
2. In the future, revenues and related accounts receivable should be recorded as such in accordance with generally accepted municipal budgetary and accounting principles; that is, they should be "measurable" and "available", as discussed in this audit report. With regard to State and Federal aid - where the incurrence of an expenditure by the City creates an entitlement to such aid - revenues should be recognized in the accounts upon the incurrence of such expenditures, subject to appropriation, statutory, regulatory or other limitations of the grant.
3. All City agencies should be required to attest to the accuracy of their department's supplementary revenues receivable balance at least quarterly. Special attention should be given to those receivables which are reimbursements of costs incurred. These should be monitored closely to make sure that budgeted receivables are adjusted to reflect changes in actual and anticipated expenditure levels. As part of the monitoring process, copies of all departmental claims for aid and/or reimbursement should be filed with the responsible central City agency.
4. Where a question exists as to the collectibility of a receivable, it should be confirmed with the responsible funding sources. Periodic confirmations of all receivables should also be made.
5. All adjustments to accounts receivable should be processed with the written concurrence of the concerned agency and with adequate explanation indicating the basis for the change.
6. Internal City authorizations for the sale of RANS should require a certification that the stated collateral balances are based upon the City's most current available data.

7. Revenue anticipation notes which have as collateral supplemental revenues receivable should be scheduled to mature no later than the dates those revenues are expected to be collected.

8. Where there is doubt concerning the collectibility of a receivable, a reserve should be created to the extent necessary to assure that the stated receivables present fairly the amount reasonably estimated to be collectible.

9. Individual agencies should be required to reconcile their records with the City Comptroller's central records monthly, and file a positive report attesting to such reconciliation.

Comments of the City Comptroller on Draft Audit Report

Pursuant to the City's historic accounting practices, the City Comptroller's books reflect revenue from all sources as estimated by the City Bureau of the Budget and identified in annual budget documents.

Unless the Comptroller is otherwise notified by the Bureau of the Budget subsequent to the adoption of the budget, the revenue estimates contained therewith are retained on the Comptroller's books through the fiscal year. Hence, those estimates have historically been the basis on which required short-term borrowings deriving from cash flow needs have been effected.

Differences between the State Comptroller's findings as to receivable balances in Fiscal Year 1973 and Fiscal Year 1974 available to support short-term borrowings by the City in those periods and the balances on the books of the City Comptroller are further explained by the following:

1. The State Comptroller and the City Comptroller have referred to different base dates for purposes of establishing balances of aid receivables available to support borrowings. At the time of the publication of notices of sale, the City has historically relied on receivable balances as of the date closest to the notice of sale date for which computer-run revenue reports have been available. Such computer-run revenue reports frequently antedated by many days the settlement dates on which borrowed funds were actually delivered to the City. The State Comptroller's after the fact examination has allowed him to test receivable balances on the actual date of borrowings against the extent of the borrowings themselves. Hence, actual outstanding receivable balances at the time of a notice of sale may have been reduced by collections at the later time of the settlement of a loan.
2. Until December, 1974 the City's estimates of receivable balances available to support borrowings in anticipation of State and Federal aid excluded aid due to the Health and Hospitals Corporation. This unnecessarily understated the receivable balance, frequently by a large factor.
3. Borrowing in anticipation of State and Federal aid has historically been based on unaudited estimates of the Budget Bureau. These estimates have not been revised until six months after the close of the fiscal year. Even then, their revision has been based on information supplied by City agencies, ~~not~~ <sup>not</sup> confirmation by State and Federal sources.

As a result of reforms in the Comptroller's Office, computer data on aid actually received is now produced weekly rather than monthly. Hence, borrowings for the City are now based on more current receivable balances.

Further, the City Comptroller has been designing a Federal and State receivable verification system. This will enable the Comptroller to update continuously the Budget Bureau's estimate of aid balances.

The City Comptroller has supplied the State Comptroller with a detailed statement respecting recommendations for conforming New York City's budgeting and accounting practices with standards established by the State Comptroller and the Municipal Finance Officers' Association.

Auditor's Comment: The reliance by the City on the latest available computer-prepared revenue reports generally resulted in the use of data which was often a month old. As noted in the City Comptroller's comments, there may have been collections against these receivables in the interim. However, it did not appear to be City practice to reduce the amount of notes sold by the amount of such collections. In any event, the receivables were substantially overstated, as indicated in this report.

New York City: A Short-Term Solution—A Long-Term Plan

By:

J.A. Schnepfer  
 Assistant Professor  
 Economics Department  
 Rutgers College  
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At 12:01 A.M. on July 1, 1975, Mayor Abraham D. Beame of New York City Ordered "crisis budget" layoffs of 19,000 city workers—the result was an urban nightmare. Fun City became "Mugger City" as outraged unions responded to the first civil service layoffs since Fiorello La Guardia was mayor. Firemen became sick, while the entire sanitationmen's union imposed a wildcat walkout which buried New York City in 28,000 tons of garbage each day.

New York City was in trouble, and is in trouble today. The problem is money. Very simply, the city's revenues fall far short of their service required expenses. Like the worker heading for bankruptcy, New York City is spending more than it earns. It is the purpose of this paper to examine the situation as it happened, what solutions have been proposed, the reasons for their failure, and a final alternative to municipal bankruptcy. We will look at the actual causes of the crisis and the basic restructuring that must be done to eliminate them. Finally, the potential impact of failure—default—will have to be investigated.

Crisis recognition began in February 1975, when a law firm (White and Case), inexperienced in general obligation municipal underwritings, was asked by an executive of Banker's Trust to examine a new city offering. When financial figures were requested, they were found to be unavailable. Unanswered questions led to more questions. The true nakedness of the emperor soon became apparent to all. Mayor Beame's July budget made the proclamation official.

Rather than recognize and deal with the true root causes of the problem, New York's financial wizards first attempted

to apply fantasy financial makeup. The city's first bluff was the creation of a state agency, the Municipal Assistance Corporation ("Big Mac") to sell \$3 billion of tax exempt bonds. The attempt to redeem maturing short-term debt with medium- and long-term securities soon fell flat. The initial sale of \$1 billion worth of bonds soon sold at deep discounts. The bonds were revenue bonds, to be paid from income derived from the city's sales and stock transfer taxes, both to be collected from the state. Even with a debt service coverage of 2.5 times (compared to a typical 1.5 times for revenue bonds), confidence in city issues was gone. When Big Mac's offering statement admitted that bondholders would have no lien on the taxes backing the bonds, the game was up. With no lien, there really was no backing, and a record coupon rate of 9.5% meant little on the 15 year bonds. The credit risk was too high.

With Big Mac bonds selling at times over 20% below face value, Beame and New York Governor Hugh Carey developed a brilliant plan to expand Mac borrowing authority from \$3 to \$5 billion. When the banks stopped laughing, a new "solution" was developed.

The state, under quickly passed emergency legislation, stripped the city administration of powers over revenue and spending. In return, the city was to be granted a three month financial reprieve. In a complicated \$2.3 billion package, the city would receive \$750 million from the state, involving three monthly state note sales, \$725 million from state and city pension funds, and various other loans, securities' roll-overs, and investments. The funds would be used to buy debt securities from Big Mac, which would, in turn, channel the proceeds to the city to pay its debts.

The state would substitute its own credit for that of the city. In exchange, the final say on all city fiscal mat-

ters was ceded to a seven man Emergency Financial Board dominated by the state. The hidden faults in this "solution" soon became clear. The taint of the city fell upon the state. The state's first monthly sale of \$250 million of notes demanded a record high interest rate of 8.7%. The Court of Appeals subsequently decreed that the legislative mandate ordering State Controller Arthur Levitt to invest state pension funds in Municipal Assistance Corporation bonds was unconstitutional.

Again, as in all cases where financial and managerial ineptitude have created a monetary shortfall, supplicating eyes turned toward Washington. Senator Hubert H. Humphrey mobilized his Joint Economic Committee to come to the aid of New York City. Representative Tom Rees of California introduced legislation to provide federal guarantees for municipal bonds, guarantees which would operate in a similar manner to the loan guarantee provisions which bailed out Lockheed Aircraft Corporation.

As of the first weeks of October though, federal aid plans were still long shots. Both the Ford Administration and most of Congress were opposed. Permanent solutions, dealing with the causes of the problem and implementing remedial structural readjustments, would take too long to put into action to satisfy New York City's short term needs.

What is needed is a short term band-aid to stop the financial bleeding long enough to operate on the basic disease. What I would like to propose, as a temporary remedy, is the establishment of a state chartered "Bank of New York City."

The crisis today is one of confidence. New York City and, now, New York State both lack the reputation of being

prudently managed financially. The public therefore refuses to directly invest in their high risk securities, without any form of insurance. If New York State would charter a state run "Bank of New York City," that bank would surely attract deposits by public-minded unions, pension funds, and individual city and state employees. These deposits, and the bank itself, would be protected by Arthur Burns's Federal Reserve System. As a lender of last resort, the Federal Chairman has already promised aid to banks if they get into trouble buying New York City securities. Time deposits would be guaranteed by the Federal Deposit Insurance Corporation. Thus, there should be minimum risk and full confidence in making these "New York City Bank" deposits. They would be no different from checking and saving accounts in any commercial bank.

Using these deposits as reserve funds, the "Bank of New York City City" would be able to finance the city by purchasing Big Mac Bonds directly. Assuming the absolute worst, that New York defaults on the bonds, the depositors of the bank would be protected by the normal safeguards. In effect, the legislature of New York State would be securing back-door federal insurance.

The bank's charter must be short lived, though. The creation of the bank is a band-aid, not an answer. It must not be used as a permanent mechanism to avoid financial responsibility. It cannot be allowed to develop into a state printing press, fueling inflation and substituting political convenience for needed economic pragmatism. I suggest it only as a temporary salve, to prevent the possible catastrophic effects of city-state default.

In the words of Federal Reserve Board Chairman Burns: "If this crisis isn't resolved, it could injure the recovery

process that is under way in the national economy." Default would create an irreversible exodus of business from the city. Years of litigation and appeals would follow. Conflicting claims between lenders, employees, pensioners, welfare recipients, and others would have to be adjudicated. Massive layoffs and strikes would result. Despite Federal Reserve support promises, the effect upon our banking system, already weakened by holdings of dubious real estate investment trust paper, would be a disastrous destruction of public confidence. Liquidity would be severely pinched by the freezing of large portions of bank assets.

Potential default has already, for all practical purposes, removed New York City from the financial markets for years. New York State's credit rating, contaminated by the city's troubles, has fallen deeply, too. Default fear has also raised the cost of borrowing for every municipality and state agency in the country. Actual default could paralyze and potentially destroy the whole municipal capital market. It, therefore, becomes imperative to buy time for New York City. A "City Bank" would do this.

A "City Bank," however, would not tackle New York's real problems. City officials just have not been able to control New York. Some of New York's problems are national problems. Since World War II, most large cities have experienced a sharp shift in population, with poor people, most of them black, moving in and middle income people, most of them white, moving out. Business, too, has increasingly deserted the cities, further eroding the economic base. Each year since 1969, 400,000 jobs have gone out of New York City. The 2 million middle income persons who left for the suburbs have been replaced by 2 million poor blacks, Puerto Ricans, and whites.

Political games have been tried to cover up the problems. It began in 1965, with then Mayor Robert Wagner getting then Governor Nelson Rockefeller to have the legislature passing a law allowing the city to market a new kind of debt instrument—Revenue Anticipation Notes—notes which borrowed against money the city might get—maybe. But what kind of real revenue was coming in to back these notes? No less than 36% of all real property in the city, with an assessed value of \$22 billion, is exempt from tax. If the World Trade Center alone paid normal real estate taxes, New York City would receive \$40 million more per year.

Twenty-seven percent of the city's budgeted revenues are generated from real estate taxes. But this assessed tax base of over \$39 billion is decaying rapidly. Thousands of vacant lots and abandoned buildings on which no tax will ever be collected have been kept on the city tax rolls by city accountants. The real vacancy rate in office buildings is now estimated at 10% to 12%. At least 10,000 apartments have vanished each year with slowed construction and increased abandonments. Collections are also dying. Last fiscal year \$200 million in property taxes were not collected and \$500 million in owed back taxes remained unpaid. The present tax delinquency rate is over 7%, the highest level since the Depression.

The political games were not limited to accounting tricks. Jobs meant votes. Since 1961, with no substantial increase in the population, the city has added 100,000 employees. With a payroll of approximately 320,000, New York has one civil servant for every 24 citizens; Los Angeles has one for 55, Chicago one for 73. The expense budget since 1961 has grown from \$2 billion to over \$12 billion. Over half of that has been in increased wages, fringe benefits, and

pensions. City pay rates have grown an average of 9% a year since 1955—50% faster than salaries in private industry. During mayoral election years, the payroll rise approached 14%.

When John Lindsay became mayor, about 500,000 New Yorkers were on welfare. Today over one million people are receiving payments. Even with state and federal help, the city's direct welfare payments cost \$799 million, increased by an additional \$282 million for welfare labor costs. Enriched services, like free day care centers for non-working mothers, impoverish the taxpayers of New York. But they buy votes.

New York City provides services unlike any other city in the nation. Anyone with a high school diploma can go to the City University--free! And they can be taught by professors earning up to \$36,000 a year for as little as 9 student contact hours a week for 30 weeks. At a pay rate of over \$1,300 per student contact hour, the city can hardly be getting its money's worth.

New York City has 123 hospitals. No coordination exists between the municipal and private-voluntary hospitals. When one-fourth of the city beds are vacant and the voluntary ones are almost always full, why is there no coordination?

In 1960 the Board of Education had 44,000 employees for 986,665 students. Today the payroll has doubled with only a 10% increase in student population. The average teacher makes \$17,000 for a 180 day work year.

Why does the city pay \$74 million per year for outside consultants to duplicate functions that present city employees should have been doing all along? Why do we have semi-useless agencies like the Taxi and Limousine Commission

with 116 employees and an annual budget of \$3.3 million? Why are city sanitation costs three times that for comparable work done by private concerns? Why does the Welfare Department need its own television camera crew? Why must the Human Resources Administration spend \$1 million on public relations? Why are not our firefighters allocated and assigned in accordance with predicted geographical and time related patterns of fires? Why were our pension cost projections based on a ludicrously outdated 1914 actuarial base? How can New York's mayor and controller differ by almost a half billion dollars in budgeted current expenses?

The answer to the above questions is simple: the answer is politics. Those in charge of New York City oversee it; they do not govern it. Hard, unpopular decisions need be made. These decisions do not engender ballot support. A Wagner running for Governor, a Lindsay running for President, could not and did not make the hard choices.

While a "City Bank" would buy time, maybe three years for New York, what long term structural changes are necessary? First a non-politically ambitious city mayor must be elected. Perhaps a six year non-renewable term would enable him or her to make the unpopular but right decisions without having to face an angry city electorate every four years.

The mayor's biggest challenge will come from the city public employee unions. To aid the mayor here, compulsory and legally binding final contract arbitration should be mandated for collective negotiation impasses. Union leaders would be judicially bound by the arbitrator's findings, removing or at least lessening the impact of union member pressure for "unacceptable" salary and pension increases. Public employee impasse arbitration already exists throughout New York State except, geographically, for New York City.

The city must balance its budget. The real dollar numbers and the assumptions behind them both must be made public. Union mentality must be converted from "what can I get?" to "what can we work out?" Maintenance of current positions must be substituted for increases in benefits. Cooperation must replace union-management competition.

The City University incurs labor costs alone of \$507.5 million. With State and Federal Loan guarantees already in effect, student loans of at least \$1,000 a year are available to even the most indigent. Therefore, not a single student would be denied an education if tuition of \$500 a term were to be imposed. Considering New York City's current financial position, it should be imposed.

The Civil Service can no longer continue as the sinecure of the incompetent. If one cannot do the job, he or she should be let go. A single board might be set up to review dismissal decisions—but no "binding forever" atmosphere should envelop the employment relationship. Productivity, not longevity, must be the guideline.

Most welfare is a necessary expense. A moral social responsibility exists where people cannot take care of themselves. But costs can be cut. If ten welfare mothers cannot work because of their children, train five to work in a city day care center, so that the other five can look for jobs. If a single woman has five illegitimate children, public policy and state interest would mandate compulsory birth control as a welfare eligibility requisite. True, the woman has a right of privacy to do what she wants with her own body. But when she seeks public support for herself and the products of her unfettered rights, those rights must be subject to a limited state control.

Most import of all, an attitude of "jeitoe" must be devel-

oped. "Jeito" is the Brazilian concept of finding a way. A way exists for New York City to extricate itself from its financial crisis. A "City Bank" would be a short term measure. Long term solutions do exist. They will involve sacrifices, political, social, and economic changes. They will mandate a new honesty, a recognition of practical realities. New York City might well paraphrase the words of Mark Twain: the reports of its death, too, have been grossly exaggerated.

Table 1

	<u>Per Capita City Service Costs</u>							
	<u>Police &amp; Fire</u>	<u>Health &amp; Hospital</u>	<u>Education</u>	<u>Public Welfare</u>	<u>Debt Interest</u>	<u>Pension Fund</u>	<u>Other</u>	<u>Total</u>
New York	\$100	\$151	\$295	\$316	\$66	\$88	\$430	\$1,446
Atlanta	41	68	245	10	34	12	252	650
Chicago	69	30	260	21	24	14	297	715
Detroit	70	60	241	26	25	5	266	693
Los Angeles	75	51	260	144	15	21	309	875
Philadelphia	91	48	217	18	41	22	294	731

Table 2

New York City's Budget (in Millions of Dollars)

	<u>1964-65</u>	<u>1974-75</u>	<u>Percent Increase</u>
Welfare	\$416	\$2,421	482%
Education	675	1,912	183
Debt Service*	470	1,435	205
Pensions	326	791	143
Police	236	734	211
Environment	144	330	129
Fire	120	307	156
Other	675	2,147	218
Total	\$3,355	\$11,104	231%

\*Includes interest of \$144.3 million in 1964-65 and \$646.6 million in 1974-75.

Table 3

New York City Budget Allocation

	<u>1966</u>	<u>1974</u>
Education and Library	23.7%	21.8%
Health Services	12.4	8.5
Social Services	18.7	28.8
Public Safety	11.4	9.4
Pension Funds	5.7	7.4
Debt Redemption	12.5	7.0
Debt Interest	2.0	4.5
Other	13.6	12.6
	<u>100.0%</u>	<u>100.0%</u>

(\$3,084 million) (\$10,249 million)

Table 4

Public Employee v. Private Sector Wage Gains

	Average Annual Increase <u>1955-73</u>	Percentage Increase <u>1955-73</u>
All Private Industry	4.7%	129.3%
Manufacturing	4.6	124.0
Federal Govt. (Civilian)	5.9	182.9
All State and Local Govt.	5.6	165.2

\*Note: The average annual increase for New York City  
(1955-73) was 9%!

Table 5

New York City Short-Term Debt Maturity

Notes due on:	Amount (millions of dollars)
October 17, 1975	\$420
November 10, 1975	250
December 11, 1975	400
January 12, 1976	620
January 13, 1976	200
February 13, 1976	290
March 12, 1976	341
June 11, 1976	280
	<hr/>
Total	\$2,801
	<hr/> <hr/>

## NEW YORK'S FISCAL CRISIS IN PERSPECTIVE

by

W. Philip Gramm

I am happy to have the opportunity to submit my testimony on New York City's financial crisis to the Senate Committee on Banking, Housing and Urban Affairs. The principle conclusions of the testimony presented below are:

- (1) New York City is not bankrupt or insolvent, but is illiquid.
- (2) New York City is capable of solving its liquidity problem in the same manner it did in 1932-33.
- (3) There is no evidence that the municipal bonds of cities have weakened relative to other debt instruments due to New York City's crisis.
- (4) A default of New York City bonds will not cause a financial collapse or destroy the market for quality municipals.
- (5) The disadvantages of federal intervention far outweigh the advantages.

When measured in terms of the value of its physical assets and income flows susceptible to taxation, New York City is probably the richest city in the world. The \$7.1 billion debt outstanding in March when the market for the City's bonds and notes collapsed was but a small fraction of the value of assets and income flows against which the City could levy taxes. While the bonded indebtedness of the City has grown by over 20 percent in the last decade, the market for its bonds and notes has not collapsed because the City lacks the ability to pay its interest liabilities or bonded indebtedness. The collapse of the City's access to capital has occurred because it

has shown no willingness to either control spending or raise taxes to offset budget outlays. Despite the receipt of over \$2 billion in revenue sharing, the City government has allowed such a gap to grow between income and spending that it has been forced to resort to unsound financial practices. It has borrowed money to pay operating expenses, pillaged its contributions to pension funds to meet current expenses, and over a third of its "capital budget" will go to operating expenses this year.

Investors have known of these activities for over a year, and the market for the City's bonds has reflected it. Since October 1974 New York has had difficulty marketing its bonds, and in December the City paid 9.5% on \$600 million of revenue and tax anticipating notes. In the same month the rate on Bond Buyer's Average Index of 20 municipal bonds was 6.8%. Because the investors knew New York City bonds were "risky," given the level it was spending relative to the level it was willing to tax, the City was forced to pay about a 40% premium to borrow money by the end of 1974.

New York City became financially illiquid due to its unwillingness to show investors any commitment to either control spending or raise taxes. A significant gesture to control spending or raise taxes would solve the liquidity problem by re-establishing the market for the City's bonds. In the reforms of 1932-33, holders of City debt demanded several years of economizing which reduced the City budget by 18% as a condition for extending new credit. A similar commitment to cut spending or raise taxes would not only bail New York City out of its illiquidity problem, but would serve as a needed step to re-establish its financial stability. A once-and-for-all federal grant would temporarily bail New York out of its illiquidity problem, but would neither re-establish the City's credit nor solve its problem of

fiscal irresponsibility.

It has become politically popular to defend federal aid to New York City on the basis of the assertion that the ability of other cities to borrow is dependent on the fate of New York City. Both current and historical data show such an assertion to be false. The investor is perfectly capable of gauging which municipals are risky and which are not. New York City's problems have had no discernible effect on the rates other municipals have yielded relative to a general index of credit instruments. While municipal yields have risen from 7% in July to 7.7% in October, prime bank loan rates rose from 7% in July to 8% in October. Those who have used the rise in municipal rates as a justification for granting federal subsidies to New York City to prevent further rises in municipal rates are simply ignorant concerning current credit conditions. While a default by New York City may cause a slight ripple effect, there is no evidence to suggest that the access to credit for cities operating on a sound financial base will be impaired. When Studebaker ended its U.S. production it had no impact on the marketability of GM bonds or stocks.

The major source of the threat of default of New York City bonds is the potential presence of federal intervention. If the government of New York City and its creditors were certain that there would be no federal intervention, there would be little chance of default. Both the debtor and creditors would have a mutual interest in finding an accommodation. So long as there is a good chance that Uncle Sam will intervene in the event of a default, the City will not be forced to take the bitter pill of revamping its financial base.

If New York City defaults it will be because the City government expects the federal government to re-establish its credit. Only such a possibility makes default feasible. Without it, closing off access to credit would be avoided even if it meant a capital levy on all property and a once-and-for-all tax on income to prevent default. The only real advantage of federal intervention is in preventing a temporary default on City bonds and a forced accommodation between the City and its creditors. In the event of a federal bailout, the taxpayer of the City will gain since he will temporarily escape having to pay the bills. The consumer of City services will gain since he can then temporarily continue to live high on the hog, and the holders of the City bonds will gain since they will get the interest premium for holding a "risky" bond and will escape the risk. 9.5% tax free bonds are a good deal if you can get Uncle Sam to guarantee them. It's not surprising that the City's large banks hold over 40% of them. The losers from a federal bailout will be the federal taxpayers who will not only bear the burden of bailing out New York City but may be forced to bail out the host of other cities who will follow New York's example if irresponsible spending is rewarded with federal grants. The private borrower who must compete for funds with a federally guaranteed, tax free bond will also lose.

Debt is a powerful tool which must be used by government and business alike only for productive investment which is self-liquidating. If the Dutch traders, who bought Manhattan Island

for \$24 worth of beads and trinkets, had borrowed that \$24 (at 8% interest) on the credit of the future city, the value of that debt would be \$17 trillion today and New York City would be insolvent. Fewer public decisions in the history of our country have been as clear cut in terms of which course of action serves the public interest. I urge you to reject federal aid to New York City.

W. Philip Gramm

STATEMENT BY JERRY WURF, INTERNATIONAL PRESIDENT  
AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES

Mr. Chairman, my name is Jerry Wurf, and I am president of the American Federation of State, County and Municipal Employees.

Our union has approximately 700,000 members and is the bargaining representative for about one and a quarter million workers in state and local government. We have more than 100,000 members in New York City.

I am here in support of immediate federal action to stabilize the credit market for New York State and New York City. Our union supports solutions to the city's fiscal crisis which involve a minimal cost and a minimal risk to the federal government. We support solutions which preserve the separation of powers between the federal government and state and local governments -- and which leave accountability for public services in the hands of elected state and city officials.

We all know that some of the officials responsible for the fiscal affairs of New York State and New York City have made decisions which are coming back to haunt the public in these times of economic distress. But the 8 million residents of New York City must not be made to further suffer for the mistakes of the public officials who govern them. It is time now to define problems -- and to seek solutions, instead of scapegoats.

State and local governments rely on taxes that hit hardest at working people whose incomes have fallen during this recession. The U.S. Department of Commerce reports that revenues from property taxes -- which are by far the most important source of local government revenues -- rose by only 2 per cent last year.

But double digit inflation has increased the cost of government -- the cost of supplies, the cost of fuel, and the cost of labor.

The costs of government skyrocket. The revenues that pay for government decline. The result is widening budget gaps at all levels of government. In the absence of federal assistance, the only options for local governments are to raise taxes, to reduce services, -- or to borrow money.

Many communities have exhausted their taxable capacity. They have cut vital services to the bone. And they have been forced into the municipal bond market — at a time when the failure of national economic policies has made this market chaotic.

The unreasonable monetary policy of the Federal Reserve has played havoc with the overall levels of interest rates. The market for tax exempt municipal bonds has been especially victimized.

The incredible fact is -- state and local governments are being forced to pay higher interest rates for issuing their tax-exempt securities than the federal government is paying for its taxable borrowing.

During the past year, the interest rates paid on municipal government bonds have risen to record levels...while the interest rates on federal government securities have declined.

As recently as 1973, the average rate of interest paid on high-grade municipal bonds was 5.18 per cent, according to Standard and Poor's. The average rate on tax exempts rose to 6.09 per cent in 1974, and, by mid-September, 1975, the average yield had risen to 7.28 per cent.

This phenomenally high rate actually understates the magnitude of the borrowing problems faced by municipalities. The 7.28 per cent average interest rate includes only those municipalities that have been able to sell their bonds. The figure does not include the local governments that have been forced to withhold their debt issues after discovering that the market demands exorbitant interest rates -- or that there is no market at all.

Last month, the spread between interest rates on high-grade municipal bonds and rates on Treasury bills reached nearly 1 per cent. This represented a turnabout from 1973 and 1974 when Treasury bills were nearly 2 per cent higher than municipals.

Why is the municipal financial market collapsing?

The nation's major banks, headquartered in New York City, dominate municipal finance. These banks have a virtual stranglehold on a municipal bond market that is very narrow because only the wealthiest Americans have been the purchasers.

Representatives of these banks -- which have formed a consortium to deal with New York City government -- have testified before this committee. While New York City amassed \$13 billion of debt, those banks did not complain of fiscal irresponsibility by city government. They were concerned with making profits selling and underwriting the city's paper.

Now an economic climate that is characterized by a severe monetary crunch and rising interest rates has created new needs and opportunities for the major banks.

Recently they seized what they viewed as an opportune moment to jack up interest rates on the city's bonds. But what began as a scheme to increase bankers' profits culminated in the loss of investor confidence in New York City. By destroying the city's tenuous financial structure, the bankers made it impossible to find customers for the city's bonds -- and left themselves holding virtually unsaleable securities.

The bankers are enjoying the highest interest rates ever. But city employees have entered into agreements under which they accept layoffs, accept a wage freeze, and accept changes in contractual work rules -- all in return for guarantees that regular city employees will not lose their jobs.

You have been told that New York City employees are overpaid and underworked.

Alice Rivlin of the Congressional Budget Office prepared an outstanding study of New York City's fiscal crisis. The study finds -- and I quote:

"Considering that New York's cost of living -- as measured by the Bureau of Labor Statistics' intermediate family budget -- is higher than all but that of Boston, its wages are not particularly out of line."

According to the Bureau of Labor Statistics, New York City employees salaries rank behind those of municipal workers in Los Angeles, San Francisco, and Detroit. Average monthly salaries are:

- - \$1,180.92 in Los Angeles
- - \$1,144.87 in Detroit
- - \$1,094.94 in San Francisco, and
- - \$1,062.07 in New York City.

But, fundamentally, public employees do not write out own contracts. Collective bargaining is a bilateral process in which labor and management sign an agreement that both think they can live with. In New York City, AFSCME contracts have required approval not only by the mayor but also by the City Council, the Board of Estimate, and, directly or indirectly, by a politically hostile State Legislature (as well as a generally hostile governor).

The concern for the problem of productivity in public service -- and it is a real problem -- should be directed towards the goal of professionalizing public management. For too long, public managers have been named from the ranks of the political faithful -- or, if we're lucky, from the ranks of leading law schools. America is alone among the industrial democracies of the world in failing to train and develop a corps of professional, non-political public managers who are experts both in administration and in the specific disciplines which they oversee. It's time to eliminate political manipulations and demagoguery from the delivery of public service.

In the current crisis, our union has been willing to bargain in good faith regarding possible solutions to the city's fiscal crisis.

We reached one agreement with the city, the state, and representatives of the bankers. This agreement contained the sacrifices I have mentioned -- sacrifices which have not been matched by any other segment of the New York community.

Now public officials and bankers -- who reached this agreement with us -- are threatening unilaterally to abrogate it. This we will not accept.

We will bargain with flexibility over the needs of the city. But the corporate institutions and public officials that caused this crisis -- and profited by it -- must not unilaterally set aside the results of bilateral agreements reached in good faith.

While our members are making considerable sacrifices, the utilities, the banks, and the private vendors, and the private contractors have not been told to lower their charges to New York City.

These companies are raising their prices -- to consumers and directly to the city government. Meanwhile, the non-elected fiscal emergency boards, with their high-paid administrators, lawyers, and publicists, have become a new burden to the city.

The president of the New York Telephone Company, William Ellinghaus, is a key member of the non-elected, non-resident boards that are managing New York City. Since, 1970, this public utility has borrowed an average of \$1 billion a year for five years -- a figure that dwarfs the city's borrowing. The utility's charges to consumers went up more than 30 per cent -- a faster rate than taxes have increased. Now the phone company is asking for a new \$488.8 million rate increase. New York Telephone is also increasing its charges to the City of New York.

Meanwhile, the banks have not been able to restore confidence in the city. Left with large amounts of city securities in their portfolios, the banks have sought -- and received -- assurances from Dr. Arthur Burns that the Federal Reserve will come to the aid of any bank which might suffer liquidity problems because of the New York City crisis.

Mr. Chairman, we know that the Ford Administration stands ready to bail out the banks that hold New York City paper. But what will happen to the 8 million people who live in New York City and depend on public services?

In the debate over the federal role in New York's fiscal crisis, one fact has gone virtually unnoticed -- New York City pays almost nine times as much in federal taxes as the federal government returns to New York City.

The Journal of Commerce reported October 10 that residents of New York City paid \$26 billion in federal taxes last year. Mr. Chairman, that figure accounts for approximately one dollar out of every ten in federal tax collections.

In return, according to Presidential Press Secretary Ron Nessen, the federal government sent back about \$3 billion to New York City.

We know that all federal tax dollars are not returned to state and local governments. But, by any reasonable standard, New York City receives a paltry share of federal aid.

To repeat, New York City accounts for 10 per cent of all federal tax dollars. But, when these federal dollars are shared with state and local governments under the General Revenue Sharing program, New York City gets 4 per cent of the total -- \$263 million of a \$6 billion program.

Senator Humphrey has offered what may be the most cogent formulation of the problem. He declared the question before Congress is not whether the Federal Government will act to aid New York City... but whether it will choose to act before -- or after -- a default.

Default will generate incredible uncertainties and dislocations in the credit markets. Default will threaten the entire existing structure of intergovernmental financing arrangements, there is no choice but to act.

What form should the federal assistance take?

The only meaningful assistance that can be offered involves a federal guarantee of state and local debt.

This guarantee can take one of two forms:

- - A federal guarantee of tax-exempt securities, or
- - A federal guarantee of taxable securities, with federal subsidy of 50 per cent of the interest cost.

In either case, participation in the federal guarantee program would be strictly voluntary for state and local governments. Those jurisdictions which choose to obtain federal guarantees for their securities would be assessed an insurance fee to cover the costs of potential default. Initially the fee could be set at 1 per cent of the value of the incurred debt. The fee could be adjusted as experience dictates.

This mechanism utilizes essentially the same device that operates under both the FHA and FDIC guarantee programs.

The cost of such a program would be negligible to the Treasury. It would help forestall a fiscal catastrophe that could shatter municipal finance mechanisms for years to come.

This program is a first step towards creating a balance between the responsibility to provide public service -- and the capacity to pay for it. This balance is essential to the survival of a viable federalism -- and to preserving public services in these difficult times.

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October 13, 1975

Hon. William Proxmire  
 United States Senator  
 Senate Office Building  
 Washington, D. C.

The present national debate over possible assistance to New York City and other municipalities by either the Federal Government directly or by some form of insurance company, is perhaps, one of the healthiest things that has occurred in this country in a long time.

Unlike the decision in Vietnam which was covert and made by a few people with the public getting wrong information, we are facing an equally important national problem in a way in which I believe the founding fathers intended the matter to be resolved and this is the best picture that we can present to the nation and to the world as to what this country is all about. Al Smith used to say that the best medicine for a democracy is more democracy. What have we learned? New York City starting with a Republican Mayor John Lindsay, violated a basic principle that everyone else in the 1960's violated. We assumed a never ending escalator up and Lindsay borrowed to fill yearly deficits rather than for long term debt. Mayor Beame, first as Comptroller, then as Chairman of the American Bank and Trust Company and Secretary Simon, as a partner in Salomon Brothers, were only too happy to see these borrowings.

When the economy was turned down in 1969 few people had the vision to see the escalator reversing and that New York would lose its preeminence in the brokerage and related service businesses connected with the brokerage industry. We as a city have lost a substantial number of jobs since 1969. The municipal fathers kept building and borrowing and paid no heed to the warning of the banking community which had to buy or sell these bonds.

When Mayor Beame came to office he continued to believe that there were only 5 groups he had to deal with in order to straighten things out. These were the heads of the Sanitation, Police, Fire, Teacher and Subway unions whose roles had swollen during Lindsay's administration and prior ones.

The trouble started, as the Times points out, when the Mayor and Comptroller sparred in a transatlantic shouting match over what the extent of the city's debt actually was - a fact we did not know until the day before the New York State Legislature met recently to offer assistance. All of this unfolded in a drama of an uncensored press where the trips, conferences and meetings of all concerned were

carefully followed.

Mayor Beame was given one respite and was supposed to fire some city employees after the sale of some "Big Mac" bonds - but relented and hired them back, thereby failing to take advantage of an opportunity to change the national psychology on the attitude toward New York. Finally, we saw New York State take over the finances of New York City and here one master plan was knocked out to be substituted for another where the courts have just ruled that one part of the plan is not valid. Now the nation is witnessing the final public drama of a great political debate that, in my opinion, is as it should be.

The President of the United States and his Secretary of the Treasury are claiming that a bankruptcy of New York or a default will not hurt the country or the bond and financial markets. The chief financial manager of the nation, the Chairman of our Federal Reserve Board, said the same thing until very recently when he suddenly changed his mind. In the meantime, he took the step of allowing the banks to borrow 100% on these bonds if they go into default in order not to permit a liquidity crisis in the banks. This step was taken three weeks ago.

While the above has been going on, the Presidents of the nation's three most important New York banks wrote to Congress and stated that a default will not only hurt their banks but possibly 100 other banks and a careful review of various news periodicals show that other banks are beginning to say the same thing.

On the Congressional side we are beginning to see the kind of movement that only comes when an issue becomes important. Various Congressmen and Senators are making public statements, several bills have been introduced in both houses to create a federally backed insurance company and the matter, which a year ago was considered a joke, has taken on the dimensions it deserves.

The American people seem alert, interested and aware of the problem. The national debate has done this. We finally see the two New York Senators holding a joint press conference on the subject. We see a public committee formed. We saw a 1975 version of Lady Godiva on horseback at Times Square asking for help for New York. (The original Lady Godiva paraded against taxes.) And on the home front we see the Governor marshalling all of the assets of the State to assist because he realizes that, as someone said, when the third floor of a building is on fire the entire building may burn down. New York State notes which were sold at \$100 two weeks ago and pay 8% now sell at \$93 and the State's credit could be in jeopardy.

We see the unions, which helped create this chaos, recognizing that they too must help and pledging their financial support. And finally we see the Mayor, now fortunately stripped of any power, courting the bankers at Gracie Mansion when a few weeks ago he blamed them for the fiasco. As the national debate continues and gets louder, I suggest the following.

We are a democracy fighting to preserve a system which has made this country the strong nation it is. More people are waiting on line to get in here than to get out by a huge margin, so we do have a good system. The greatest problem we have to face is time and getting time may also be our greatest asset. As the debate continues and we all realize that this is no normal recession we are in and that we are not coming out of it quickly - the political leaders may realize that this is a long term problem where, as a nation, I suspect we shall probably spend the 1970's extricating and working ourselves from the problems we got ourselves into in the 1960's. That goes for public business, private business and personal business.

I suspect that we all agree that New York City has been mismanaged and that the state has an obligation to assist it out of this mess just as the Federal Reserve Board and Treasury have an obligation to assist the government out of the mess it got into by spending 90 billion dollars more than it has as income.

Everyone became a little too big for their britches and we are in a process of winding down. W. T. Grant and Penn Central and a hundred others filed in Chapter XI. But the federal government did not wish the Franklin Bank, The Security National Bank or any other bank to file, nor did it want Lockheed Aircraft to file. The federal government has recognized that in the national interest it will grant long term loans to Lockheed. The private sector has learned that it must help work out the loans to some REITS - such as Chase Manhattan Realty which has a negative net worth and the Federal Reserve bailed out a few banks and assisted all the others.

The national debate will recognize that Lindsay and Beame mismanaged the city and that the state has now assumed management of the finances through creation of some agencies controlled from Albany and that the State intends to work with the private sector to straighten the matter out. The Governor and Legislature have shown some responsibility.

The mistake that Herbert Hoover made in 1929 was his great belief in the capitalist system to the point where he would not realize that to preserve it you must make accommodations according to the times. Herbert Hoover refused to permit the Federal Reserve Board to increase the money supply in 1930. The problem that we face now in 1975-76 is that the economies of the world, for a variety of reasons, will not recover to the position the world was in in the 1960's for a long time. During the healing period during which time we have few trained doctors and fewer medicines for the sickness of both inflation and recession because we never suffered the disease before - accommodation will be necessary in order to prevent a world wide depression.

There is, in my opinion, only one reason we do not have a major depression today and that is because the Central Banks of every nation from Argentina to the U.S. have stopped it. If in the United States our Central Bank (Federal Reserve Board) had not intervened to lower the federal fund rate last year from 12% to 4% and had not saved Franklin and Security National Bank, we would have seen hundreds of bank failures.

Help to New York one year ago would have been foolish because it would have preserved incompetence and selfishness. But necessity is the mother of invention and the State has done a great deal - possibly all it can do. The healing process is beginning to take place and the patient will recover if it gets some sympathy.

The argument that an insurance fund to assist all municipalities is not good is simply not valid. The setting up of such a federally funded program of insurance for municipal bonds not only will assist all municipalities but it will set the tone for the century that is coming by setting up certain criteria in order to be eligible for that insurance, i.e., balanced budgets.

Furthermore, I believe that psychology is as important as anything else in life. If such a fund is debated properly in Congress and in the Senate and then set up - it will assist the recovery of the bond and stock markets, restore confidence in the citizen of this country that a recovery is coming, and bring further dollars into the country from abroad - strengthening the dollar at a time when we can use that strength.

If that help is not forthcoming - the bond and stock markets will collapse, as will many banks - and there will be a flight of dollars and the government which has a 70-80 billion dollar debt to finance this year alone will not be able to sell its Treasury bills. When the banks collapsed in the 1930's and we had a national catastrophe, the government set up the Federal Deposit Insurance Corporation which insures all savings accounts now up to \$40,000. That fund not only restored confidence in banks, resulting in the growth of this country, but it has been called on very few times to make good.

A properly thought out bill will not only assist in preserving the capitalist system and democracy but it will set up the guidelines that cities will be required to do so that they are not mismanaged as New York was.

New York is the center of the world. First in finance, education, medicine, charity, media. It has been badly run and mismanaged but that is being corrected. A default here, contrary to all that has been said, will rock the boat in an economy already waterlogged. As the debate gathers momentum and the public sees what New York is doing to help itself I expect the President and his advisors to exercise the statesmanship I think they have and to show this world that we as a nation are not only good at building a defense establishment but we know how to bend and accommodate a system that we are the leaders

in - in order to insure the continuation of the system, to show it is viable, to restore faith to millions who are disbelievers and not responsible for what happened, and who will suffer greatly if New York defaults and I don't mean necessarily only New Yorkers.

Respectfully,



Laurence W. Levine, Esq.

LWL:re

# NEW YORK CITY FINANCIAL CRISIS

FRIDAY, OCTOBER 10, 1975

U.S. SENATE,  
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS,  
*Washington, D.C.*

The committee met at 10:10 a.m. in room 1202, Dirksen Senate Office Building, William Proxmire, chairman of the committee, presiding.

Present: Senators Proxmire, Sparkman, Williams, Cranston, Morgan, Tower, Brooke, Packwood, and Garn.

Also present: Senator Abraham A. Ribicoff and Jacob K. Javits.

The CHAIRMAN. The committee will come to order.

This morning we are honored by the presence of a number of distinguished witnesses and particularly by our first panel and especially by the Governor of New York, who is a former member of Congress and served with a number of us on the Joint Economic Committee.

We have three witnesses here this morning on this panel. We will have more on subsequent panels. Because we are all in such economic straits, we can only afford two microphones.

We have Governor Carey of New York. We have Mr. Felix Rohatyn, and we have the Honorable Simon Rifkind.

Gentlemen, you can present your testimony in any order and any way you desire. We have other witnesses this morning. We would appreciate it if you would like to abbreviate your testimony. Anyway, the statement will be printed in full in the record.

## **STATEMENT OF HUGH L. CAREY, GOVERNOR OF THE STATE OF NEW YORK; SIMOND RIFKIND, PAUL, WEISS, RIFKIND, WHARTON & GARRISON; AND FELIX G. ROHATYN, LAZARD FRERES**

The CHAIRMAN. We are graced and honored by the presence of the senior Senator from New York.

Senator JAVITS. Mr. Chairman, I have asked for this privilege. Our new Governor has had his share of trouble. We welcome him here and commend him to the committee. He stood up to the trouble in a most extraordinary way. New York has reason for hope and a great deal of this comes from him. I would like to introduce one of our most eminent financial authorities, Felix Rohatyn, and Judge Simon Rifkind has been my friend for at least 40 years. He is one of our most distinguished lawyers and still is carrying on so importantly in the public interest area coming to the rescue of our city which is in terrible trouble now.

I am honored to introduce these distinguished New Yorkers to the committee.

Governor CAREY. If I may, we are accompanied also by Nick DeNitzer, dean of the School of Public Administration of the New York University, member of the Board of Municipal Assistance Corporation.

Mr. Chairman, I come to you today with as great a sense of urgency as any Governor ever has felt in the history of this country. As a former Member of Congress, I know fully well how frequently you are asked for financial assistance, for tax breaks and for the means to enhance wealth or credibility. I come today on a very unique mission—to tell you that the default of New York City will cause not only the bankruptcy of the State and city of New York, the devastation of 17 million people, but unforeseeable national consequences of such adverse and sizable nature that we have no choice but to prevent them.

I sense that among people in this Nation and their elected representatives there exists a strong feeling that New York City should be punished for its past.

However you feel about New York City, a national policy of punishment will only hurt 8 million innocent Americans who live in New York City and another 4 million Americans who depend on that city for their livelihood.

What did any of those Americans do to deserve to suffer the uncertainty, the chaos, the slow death of their city which would result from a default?

I cannot stand here today and deny that New York City tried to do too much for too many and that imprudent management was certainly part of its problem.

But I do not wish to waste any further time discussing misconceptions about mismanagement or policies of punishment or apportioning blame.

I am here today to promote understanding. I am here to seek recognition for all the State of New York and the city of New York have done in recent months to repair the city's past and to prepare for its future.

Last spring when investor confidence was so severely shaken that the market for short-term city debt closed down, the State of New York advanced nearly \$800 million of State aid payments to the city in order to provide time for an orderly review of the alternatives.

I felt it was my duty and obligation to keep the White House, the Federal Reserve and the U.S. Treasury informed of the exact nature of the city's financial problems and the severe consequences a default would have on our State and Nation. I did that on several occasions. I held lengthy conferences with all officials involved. I also sought advice and constructive suggestions from those officials, and they urged us to have the State step forward. They said that they would only deal with the State in developing a possible Federal solution. So on the advice of the highest Federal officials and on the advice of highly qualified financial experts in our own State, we created the Municipal Assistance Corporation—big MAC.

Part of the city's problem at that time appeared to be an excess supply of short-term city debt, so MAC was designed to refinance this short-term debt on a longer term basis. To secure MAC obligations and to increase investor confidence in the political will behind this effort, an important part of the city's revenue stream was diverted to MAC. Finally, to restore investor confidence in the political will and

the managerial competence of city government. MAC was mandated to work with the city in instituting managerial and budgetary reforms which would restore the city's fiscal integrity.

Even after we accomplished all this, we were told by Federal officials that all we had done was to exchange short-term debt for long-term debt. They urged the State to do more.

Then over the summer it became apparent that the market had not recovered from its qualms about New York City. For the sake of that market and for the sake of the city, we determined we needed more swift and more dramatic action.

Therefore, early last month I called the State legislature into special session to consider the actions I felt were necessary to save the city from default.

The legislature adopted my proposal for a commitment of State and pension funds to meet the city's financing requirements until December of this year. We appropriated \$750 million of State funds to help the city, as part of a \$2.3 billion package. We put the credit of the State of New York on the line. It was a difficult decision, but I believe we did the right thing.

The legislature also adopted my proposal mandating the city to achieve a balanced budget in the fiscal year ending June 30, 1978, and to show substantial progress toward budgetary balance in each of the two intervening fiscal years. To assure the achievement of these goals, the emergency financial control board was established, putting the Governor and the State comptroller, the mayor and the city comptroller, and three qualified management leaders from the private sector in charge of the city's 3-year financial plan.

The board has the power and the responsibility to assure a restoration of the city's fiscal integrity. It will use that power to achieve fiscal integrity. And with that integrity should come a restoration of the city's creditworthiness in the market in due course in ordinary circumstances.

The city must submit to the board a 3-year financial plan showing a balanced budget in the fiscal year beginning July 1, 1977, and substantial progress toward a balanced budget in the two intervening fiscal years. The board may approve, disapprove, or modify the financial plan to achieve the goal of a balanced budget.

To enforce the execution of this 3-year plan, the board has the power to review and approve or disapprove a wide range of city contracts. It may suspend municipal employee wage increases to the extent it decides is necessary to achieve the objectives of the financial plan.

All city revenues are diverted to the Emergency Financial Control Board which then disburses these funds to assure compliance with the financial plan. In the event revenues in the board's fund are not sufficient to meet expenditures authorized by the financial plan, the board is required by law to make payments on a schedule of priorities which protects creditors first.

In the 33 days since the legislature approved my special plan, the Emergency Financial Control Board has proved it can meet the challenge of returning New York City to fiscal integrity.

Three outstanding members from the private sector—William Ellinghaus of the New York Telephone Co., Al Casey of American Airlines, and David Margolis of Colt Industries—have been appointed to

the board. We have met six times, and a spirit of utmost cooperation, understanding, and unity has prevailed at each meeting. Each member fully appreciates the board's critical mission.

We have determined accurate 3-year revenue estimates for the city. At this week's meeting, a week ahead of schedule, the board received the first draft of a 3-year financial plan from the city. The purpose of that plan is to reduce city expenditures to match its revenues so that when the city returns to the credit market, it will be a good investment.

We are in the process of reviewing city contracts and collective bargaining contracts. We are reviewing the city's tax revenues to determine which taxes would be extended, which should be eliminated as counterproductive, and which should be adopted as substitutes where necessary.

In short:

In a city with the strongest municipal unions in the Nation, there is a wage freeze.

In a city with the largest construction industry in the Nation, there is a freeze on new capital construction.

In the financial capital of the world, a State agency completely controls New York City's access to money.

These actions, though harsh, are not inconsistent with the steps I have had to take since the day I took office:

The actions we took to save the Urban Development Corporation.

A State hiring freeze which has resulted in more than 5,800 fewer employees.

One of the lowest collective bargaining settlements in history in which 140,000 State employees were held to a 3.5-percent increase on a nonrecurrent basis.

None of these actions is inconsistent with what is happening in New York City.

Last month, both the Democratic and Republican leadership of the State of New York faced a most difficult decision. It was not easy to decide to put the credit of the State of New York on the line to give New York City time to survive. But both the Democratic and Republican leadership of our State government felt we had no other choice.

Now our State's resources are stretched to the limit. Now, I must tell you, as a State, we have done all we can to help New York City.

The State of New York cannot guarantee the securities of New York City. We have neither the resources nor the power. In fact, our State government is smaller than the government of New York City.

Now we seek recognition from the Federal Government for what we have done. We need and we deserve Federal assistance. We are not asking for a handout or a bailout. We are asking for a sensible solution—a limited guarantee of the securities issued by the Municipal Assistance Corporation—the State financing agency for the city of New York.

The securities covered by the guarantee should be of a relatively long maturity—at least 10 years—so that with a guarantee on bonds with a principal amount of \$5 billion we can effectively handle New York City's remaining short-term debt. With the effective action of the Emergency Financial Control Board and this Federal guarantee, we will make certain this is a nonrecurring problem.

We are proposing that these bonds be taxable for three reasons:

To prevent the downgrading of other taxable securities because a tax-exempt and guaranteed security would be superior to every other security in the market.

The removal of New York State from the tax-exempt market would benefit other municipal borrowers in the country.

The taxes on the bond's income would yield revenue for the Federal Government.

The City's Emergency Financial Control Board will see to it that the city achieves a balanced budget so that the guarantee is never drawn down.

If we get the Federal assistance we need, I can promise you that after 1977, New York City will never again have to borrow beyond its means to meet its operating expenses. And I promise you that in the mechanisms and institutions I set up to meet this goal, I will not only insure that this will be true during my administration, it will have to be the policy of future Governors who may succeed me.

One of the best ways we have of preventing major errors in foreign policy is a sound system of intelligence.

A lack of intelligence information caused a great national disaster on December 7, 1941.

I come before you today with intelligence information which you must use to prevent an economic Pearl Harbor on December 7, 1975.

While I can't predict for certain all the severe national and international effects of a default by New York City, I can tell you what problems the situation has already caused in our State.

Our major State agencies—agencies with sound, secure revenues and the certain ability to pay debt service—are in severe danger of default because of the crisis in confidence in the Nation's municipal bond market.

The New York State Housing Finance Agency which has financed 800 projects worth \$5.8 billion over the past 15 years cannot find a market for its sound securities.

Neither can our State's dormitory authority, environmental facilities corporation and our medical care facilities finance agency.

What will happen to \$1.6 billion worth of projects underway by these State agencies in New York?

I can answer that.

Our State will be spotted with empty monuments to default, partially built classrooms, dormitories, public and private hospitals, mental health facilities, day care centers, nursing homes, water pollution control facilities, and housing for low- and middle-income families, to name a few of the ongoing projects—will forever stand as only steel and concrete, incomplete.

Our sick, our elderly, our children in need of education, our working mothers, and all of our citizens will forever be denied the vital services those facilities were designed to provide.

Billions of dollars in capital will be wasted.

More than 53,000 workers who depend on these four agencies for their livelihood will be sent to the unemployment lines.

So I must ask, what will happen to the projects, the services, the capital, and the jobs in 33 other States with similar agencies?

New York State's localities and sewer and water authorities need to accomplish \$1.1 billion of their traditional, regular borrowing between now and March.

Yet local banks which in the past bought their paper without question because that paper was sound, have now turned their backs and closed their doors.

So I must ask what will happen to local units of government across our Nation who must have access to the credit market to meet their cash flow needs and provide services to their citizens?

Hundreds of New York State school districts will need to achieve \$1.2 billion in traditional borrowing between now and next June.

Local banks are closing their doors to our school districts.

This week I received a letter from the East Islip School District in Long Island.

The finances of that district are and always have been sound and secure.

That district needs to make three offerings of securities totaling \$5 million between now and January 1976.

Local banks in their words "are not willing to deal with us at any price."

On October 1, the school district was able to obtain a loan of \$800,000 for 30 days at a 11.15-percent interest rate. So I must ask how will the children of New York State receive their education in the future? What will happen to the future education of all the children in our Nation as the disease of default sweeps our country?

We know that most of New York State's paper is sold in New York State. But who owns New York City? Who will be hurt if New York City defaults?

Individuals with their life savings invested in New York City—not only banks—but business in every State of the Nation own New York City. So we must ask ourselves, what will happen to businesses whose future depends on loans they have secured with New York City as collateral?

The Congress of the United States must ask itself: What purpose is there now to the National Housing Act passed last year?

For that legislation assumed localities would have access to the credit market at normal interest rates.

What will become of that legislation with the municipal market in shambles?

The Congress must also examine the effects of New York City's problem on its local revenue sharing programs.

I know of one respected economist who estimates that skyrocketing municipal interest rates could cost localities across this Nation up to \$3 billion. That would negate one-half of the Federal general revenue sharing funds. What Federal plan is there to help the citizens in localities across this Nation faced with increased local taxes to pay those interest costs?

If the purpose of nonintervention on the part of the Federal Government is to teach New York City a lesson and force it to economize, there is a sense in which this policy might turn out to be both ineffective and extremely costly to other governmental units.

What notice will there be for the city workers to continue their self-sacrifices and to provide vital services with the city as a trustee of the Federal Government?

A city in default is a demoralized city. Will a city under Federal occupation and control have any motivation to pay its debts?

Those governmental units that have issued long-term bonds at higher interest rates and do not default, on the other hand, will be forced to continue to pay these higher interest rates over the life of the bonds. The question is: Will most governments be willing to do this after there is a New York City default? Or will they see default as an accepted way to unload their debts? Do we, as a Nation, want to set national policy which encourages local government to throw in the sponge, to give up trying?

New York wants to pay its debts, we want to attend to the errors of the past. We simply seek recognition for all we have done.

I am the first to admit that under the system New York City used to keep its books, it was difficult, to say the least, to get proper information on the city's financial situation. Now the books are not only open, the figures are sound and dependable.

I invite any member of any congressional committee, or for that matter, the administration to examine the books of New York City or New York State. We invite constructive suggestions and advice.

It seems I have raised as many questions as I have answered today.

The fact we have no answers to the questions points to the fact we need in our Government an orderly system in which we can find these answers, so we do not have to speculate on the unforeseeable effect of default on our Nation's economy. Whoever is willing to stand up to the questions I have raised today will never again be able to say that the effects of a New York City default would be contained within the borders of our city or State.

Whoever is willing to stand up to these tough issues will never be able to deny that New York City's problems are national, indeed international, in scope and effect. And no Member of the U.S. Senate will be able to overlook the certainty, that if New York City is allowed to default, the financial problems of New York City will be in his State very soon.

The choice before the U.S. Congress is clear:

Either a limited guarantee of the securities of New York State's bonds which will cost nothing, which will, in fact, add revenue to the Federal Treasury;

Or a default of New York City, which I am certain would be the most costly mistake in the history of this Nation, economically, in dollars, in human suffering and in the erosion of our democratic institutions.

I cannot deny that there is a contagion in New York which is about to sweep across the Nation. Don't kill us because we are ill.

We are asking for your assistance so that we can cure ourselves and contain the contagion. I do not relish the prospect that on our Nation's bicentennial anniversary, the city which was this Nation's capital in 1789, may be occupied by the Federal Government. Nor do I look forward to the slow yet certain death the financial, cultural and entertainment center of the world would suffer if it is denied Federal assistance and allowed to default.

Mr. Chairman, I look forward to the Congress of the United States in the great tradition of this body, acting in the national interest in a timely manner to help us cope with our condition.

The CHAIRMAN. Thank you, Governor.

Mr. Rohatyn.

MR. ROHATYN. My name is Felix G. Rohatyn. I am a general partner in the investment banking house of Lazard Freres & Co. I am here today in my capacity as Chairman of the MAC to ask for your support for a Federal program to prevent the unnecessary default of the city of New York. I believe that both from a banking as well as a human point of view this is a tenable position. But let me first, as an investment banker, talk about the city. There I am concerned with certain issues:

1. Whether New York City is financially sound.
2. Whether it is viable from a management point of view.
3. Whether it can provide its services at an acceptable cost.

When Governor Carey asked me in late May to assist on a panel to help resolve a mounting crisis, it was apparent that none of these criteria were being met.

The city had no credible financial plan to get to a balanced position.

The city's management could not demonstrate that it could deliver the services required of it with the money available to it.

The city's management was not credible to the public and to the institutions whose support was required to keep the city going.

We recommended creation of MAC. The Governor accepted it. And it provided the bridge which enabled us to walk, or stagger, from June to October. At least we can point with a certain amount of pride to the fact that, as the Governor has pointed out, enormous strides have been made, and we have so far prevented a default.

I believe that today we have the main elements required to put any economic unit back on its feet. We have fiscal control, exercised by the Financial Control Board, to determine how much money the city has available to it and which sees to it that the city spending is held within those amounts. We have the beginnings of a restructuring of the operational management of the city. We have a financing vehicle in MAC.

I think you would all agree that as of today there is a plethora of talent—of business talent, of management talent that is being brought to bear on city management practices and personnel. This talent is in for the duration.

I would be less than truthful if I told you that everything today is in place to run the city as I and investors all over the country might like to see it run for the next 10 years. But the process has started and will not be stopped. The MAC legislation and the emergency legislation passed last month required that the city's budget be in balance by the fiscal year beginning July 1, 1977. The men now involved are erecting a fiscal fence around New York City—they know how to read balance sheets, read profit and loss accounts, judge management methods and systems.

The history of the past few months and specifically negotiations which involved MAC with the municipal unions have convinced me that the majority of the city's union leadership is anxious to see more efficient city management.

They see it as the only way for the city to survive and for a smaller stabilized work force to be secure about its future.

The city will get into balance because it has to. Period. Management will determine whether the city is a livable place or a fiscal success but a social failure.

All of you know that any reorganization takes time. All of you also know that it is far better, economically, professionally, and hu-

manly, to permit a sick situation to be cured over a period of time than to chop it to pieces. The cure involves imposing stringent conditions on the city.

If I am right that the control mechanism is in place and the beginnings of sound management practices have been initiated, then the need is for a financing mechanism to make it happen within the statutory 3-year period. From the outset we perceived MAC as the appropriate financing mechanism. However, while the mechanism is sound, the markets have closed down, not only around the city but on MAC and the State.

Most experts agree today that neither MAC nor the State of New York full faith and credit obligations are poor credits.

What they are facing today is nonmarketability which as you know is a quite different matter.

However, lack of marketability can be as lethal as poor credit. I believe that performance to date and the security behind MAC entitles it to a market at reasonable interest rates.

However, I question whether there is anything that we can do at this point to open the market in the near future.

The problem we are facing is also the result of a more profound and basic economic dislocation.

Whether a dramatic or conventional form of fiscal discipline is involved, one fact is clear. A severe capital shortage is looming over the next decade or two.

This shortage is going to affect every person in this room and every city and State to which you are committed. It is going to put significant restrictions on this country and will create greater and greater requirements for efficiency on the part of elected officials to enable them to deliver services to their constituency.

Politicians will have to learn not only in New York City, but all over this country that organizations requiring large amounts of capital must discipline themselves in order to have that capital made available.

Looking back over the last 15 years it is easy to say that the problems of the city have been caused by mismanagement and by fiscal gimmickry. It is easy to say and it is undoubtedly true. It would be equally true to say that money was made available to the city in ridiculous amounts and on ridiculously easy terms. The financial community, of which I am a member, has to bear its share of the blame for what happened to the city.

Financing vastly beyond the limits of prudence was obvious to even the unsophisticated. What happened in New York City was written on the wall. It was inevitable that sooner or later the crisis would occur and the political process failed in preventing the crisis.

Certain of New York's problems are probably unique to it—but the fact remains that New York City is not all that unique. I don't believe that most of you sitting here as you think it through will feel that your cities and your States are all going to be immune from these problems. What is the answer for us then?

Over the last 4 months since the creation of MAC we have raised approximately \$2.5 billion dollars with the superb support of the New York banking community, with additional support from other local institutions, and with practically no support whatsoever from out-of-State financial institutions. The Governor has told you what actions have been taken.

The existing financing may see us through the beginning of December although there are uncertainties even during this period. If we do reach December 1, we will have raised close to \$4 billion, involved the State to the extent of \$750 million, and scraped every known resource available to MAC, the city and the State.

By December 1 there may be some avenues still open to us in a limited way but absent to an assured financing mechanism that would enable us to fund out our 3-year plan, the odds against our winning are exceedingly long.

When, in August, it became apparent that the markets for MAC securities would be closed to it in September and the Governor asked for recommendations involving possible State and/or Federal action, we were mindful of the proposition that no Federal involvement could be contemplated until the State itself had made a major commitment both in terms of the control of the City's finances and in terms of the State's financial involvement itself.

The legislation which the Governor asked the legislature to approve contained both elements of this approach. The commitment of \$750 million of State funds spread over a 3-month period of time seemed to us to include a significant involvement of the State but in the light of the State's resources and history, did not seem to threaten the State's integrity significantly more than it was already threatened by a possible default of the city of New York.

The markets have, however, closed upon the State as well as upon MAC, and as well as upon creditworthy State agencies, such as the FHA. Without the State Comptroller's commitment of State pension funds to acquire the \$250 million of State notes prior to October 17, the State would undoubtedly be unable to fulfill its commitment to make \$250 million available to the city as part of the fiscal package at that time.

Although a default is technically defined as the failure to pay off a debt as it becomes due, in my judgment, had the State failed to meet its commitment to make \$250 million available to the city in October, as it is committed to do legislatively that would have meant an actual default in real terms, quite as serious as the failure to meet a debt maturity as it became due.

The present financial crisis of the city of New York, even after taking into account significant action taken over the past three months by city, State, financial community, and the private sector, has successively shut off access to markets of city, MAC, State agencies and, now, the State of New York itself. The total amount of indebtedness involved of these entities is close to \$30 billion, or about 15 percent of the total municipal debt outstanding in the United States.

Many arguments have been heard recently on either side of the question of the impact of a default of the city. I have given it as my professional judgment that an impact of a city default would inevitably lead to default of major State agencies, and of a possible default by the State of New York itself.

I believe the impact of such a series of defaults is not containable without major cost to the economy, and to our international position. I believe that domestically the economic recovery would be seriously damaged and that in New York City itself an irreversible exodus of corporations and businesses would condemn the city's tax base to a fatal downward spiral. Abroad it would seem to me that such a failure

would be attributed to either a fundamental structural failure of the capitalist system, or to be the result of divisions within this country so profound as to paralyze its will to act.

I realize that these are judgments, and that human judgment is subject to error. It seems to me, however, that the assumption of a major needless, and I emphasize needless, economic and social risk in the name of fiscal prudence, is neither good logic nor good policy.

We are looking for Federal involvement to maintain an orderly market in our obligations, so that we can bring our program to a successful conclusion and pay our debts 100 cents on the dollar. There are several approaches that could accomplish that purpose and we are open to different possibilities. As far as MAC is concerned, our choice would be for a program of Federal guarantees to MAC bonds, with taxable interest on those bonds at the time the guarantee goes into place.

We do believe that only State agencies such as MAC should be eligible for such Federal guarantees and that approval by Federal authorities in addition to the Emergency Fiscal Control Board of the city's 3-year fiscal plan would have to be involved. We believe that an appropriate insurance premium and the possible pledge of Federal revenue sharing to protect the Federal Government would be appropriate steps for discussion.

The hour is very late. A financial virus has existed in New York and we want to keep it from contaminating the rest of the country. You have witnessed the spread of this virus in spiraling municipal interest costs and deteriorating investor confidence. Assured access to markets while the city gets into balance is the best way to vaccinate the rest of the country against this virus.

At a time of early economic recovery a massive default anywhere is dangerous. A default of mammoth proportions, involving city and State, that was both unnecessary and avoidable would be an inexcusable tragedy.

Thank you very much.

The CHAIRMAN. Thank you.

Mr. Rifkind, do you have a statement?

Mr. RIFKIND. I shall make no statement. I shall be available to answer questions should they occur within my field of competence.

Governor CAREY. I have before the committee a letter dated yesterday and I carried with me today a copy. The letter is signed by former Treasury Secretary C. Douglas Dillon and former Secretary of Treasury Henry H. Fowler. It addresses this problem in great detail.

In brief, its recommendation is that the Federal Government adopt an appropriate affirmative role in this crisis and it indicates on page 2 at the top, first paragraph, that no one can predict accurately the consequences of default in the city's debt obligation.

But there is no doubt in the words of Secretaries Dillon and Fowler "that it would threaten serious damage to the city, State, and Nation."

I ask that the letter be included in the deliberations of this committee in the appropriate form.

The CHAIRMAN. That will be done. These are both former Secretaries of Treasury, both of whom served within recent years.

[The document follows:]

The Honorable  
William Proxmire  
Chairman  
Senate Banking and Currency Committee  
Room 5300  
Dirksen Senate Office Building  
Washington, D. C. 20515

October 9th, 1975.

Sir,

The undersigned submit this to you, and through you, to the members of the Senate Banking and Currency Committee for inclusion in the record of the current hearings on the New York City and State financial situation.

We believe that the Congress at this session should promptly authorize an appropriate affirmative action role for the federal government to work in cooperation with states in preventing the financial collapse of local government that would adversely affect the national interest. This legislation should be applicable to any state faced with a financial crisis affecting units of local government that is beyond its resources to solve effectively.

The current financial crisis of New York City, in which the State of New York has intervened, makes this policy determination desirable and timely.

New York State has assumed overall control of the City revenues and expenditures through the Emergency Financial Control Board. It has established a special state agency, the Municipal Assistance Corporation, to undertake financing designed to restructure the City's debt obligation by, among other things, transforming the City's short term debt into long term obligations. It has committed substantial State financial resources to its rescue attempt.

Despite these efforts, continued lack of access to the private financial markets and state constitutional and legal hurdles will lead to an early default on the City's debts unless the federal government lends the state a hand. That is the considered opinion of the state and city authorities, the knowledgeable bankers, the credit rating agencies and those involved in the day to day operations of state and municipal finance.

Under these circumstances the State seeks meaningful federal participation in its program to restore financial and fiscal order to the City.

No one can predict accurately the consequences of a default on the City's debt obligations. But there is no doubt that it would threaten serious damage to the City, state and nation.

For a few examples.

1. The credit of the City would be impaired indefinitely, disabling it from effectively providing essential local public services for the millions of people who live, work or travel in New York City. The risk of collapse of these services if New York City cannot borrow, while the Emergency Control Board and the Municipal Finance Corporation readjust the City's finances to a credit worthy position, is grave. The ensuing damage could be incalculable, and the social and economic consequences intolerable.
2. The financial position of the City's creditors, not only in New York City, but throughout the United States, including banks, other non-bank financial and business organizations, and many thousands of individuals would be seriously impaired.
3. The impact of a City default on New York State credit would surely threaten the ability of the State and the various state and city agencies to carry on their financing programs through the normal financial and credit market mechanisms. They are already jeopardized.
4. Municipal and local governmental unit borrowers all over the United States would find their costs of borrowing appreciably higher and, in many cases, their very access to credit markets questionable. Even before a default, the mere threat has caused interest rates on much local financing to increase far out of proportion to increases in corporate bond rates.
5. The real and psychological effect of a failure by New York City and New York State to resolve this financial crisis would injure the badly needed recovery of the national economy - witness Dr. Arthur Burns.
6. Leading foreign bankers and financial leaders voiced their apprehension frequently in the corridors of the recent Annual Meeting of the World Bank and International Monetary Fund concerning the international repercussions of the New York City default. These low key fears have now been publicly reinforced by the forthright comments of Chancellor Helmut Schmidt in the United States last week and attributed statements of European financial

leaders in recent news dispatches. The shock of confidence, with its "domino" or ripple effect could have a serious impact on capital markets everywhere. As one foreign expert put it, "Investors would invest less. Consumers would buy less." Or as another commented, "The whole system of lending money would otherwise experience a serious setback."

Given the State action described above, the urgent request of its leaders for federal help, and the vital national interests threatened by this financial crisis involving the financial capital of the United States, affirmative action by the National Government to assist the State in its efforts is wholly consistent with the constitutional framework of federal-state relationships.

Indeed, a refusal by the federal government to act, thereby assuring a default, is likely to plunge federal judicial, legislative and executive agencies directly into the local administration of a bankrupt city.

Of course, this legislative policy of federal participation in state efforts to avert a financial collapse of a local government must be established on suitable guidelines.

The method and pattern of assistance should be in keeping with the constitutional standard of appropriate federal state relationships. The arrangements provided for must be with the state and its agencies upon the application of the state. Direct channels between City Hall and Washington should be avoided. The program must be burden sharing and not buck passing.

The assumption of a role of lender or guarantor should be on terms and conditions that do not place any additional burden on the federal taxpayer, or add to the cost of federal debt servicing. The role of the federal government should be as a lender of last resort, not a subsidizer of financial mismanagement.

These terms and conditions should make the extension of assistance contingent upon an undertaking by the state to impose stringent fiscal and budgetary practices upon the local government that will assure an orderly stoppage of debt accumulation and an early transition to a meaningful program of debt retirement.

The rates of interest on a federal loan or the charge for a federal guarantee of a state or local security should be at a level sufficiently high to discourage other states and localities from turning to the federal government in this type of situation except as a last resort, when other more attractive solutions are not available.

These rather harsh standards applicable to financial rescue parties should

not imply an opinion that there should not be a re-examination of other separate longer term measures by the federal government or the states to relieve urban centers, such as New York City, of costs that should not be saddled on the local unit or are inequitably distributed. Time does not permit these answers to be worked out for inclusion in the proposed financial legislation.

We would not wish to attempt to pass judgment on the exact choice of means to be employed for federal action in this particular financial crisis involving New York. In our view, the authorizing legislation should be rigid in the standards and terms and conditions for federal participation along the lines outlined, but flexible in the instruments and methods to be authorized.

Both federal loans or federal guarantees of state or local securities should be made available. But interest payable on state or local securities issued in the public market or through private placement with the guaranty of the federal government should be subject to federal taxation in the same manner as federal Treasury securities. Moreover, as indicated above, a suitable premium should be paid by the borrower to the federal Treasury for the use of the loan guarantee. This premium would be designed to induce the ultimate borrower to conduct its affairs so as to reduce its debt burden and to regain ready access to the private capital market rather than to continue reliance on the federal guarantee.

On the same reasoning, a direct loan should be at interest rates that include a spread over the cost to the U.S. Treasury of the financing that will avoid any subsidy to the city taxpayer or place any added expense on the federal taxpayer and that will be conducive to earliest possible repayment.

It seems undesirable and counterproductive for federal participation to be conditioned on an agreement that all holders of existing securities by the City or the Municipal Finance Corporation defer payments of interest and principal so as to assure repayment within a short period of years.

There is much doubt that an agreement could be secured in time and if secured it would be clearly labelled as a forced default, however technical or managed.

A more appropriate alternative is to use interest rates on federal loans or premiums on federal guarantees that include spreads over the cost of financing to the U.S. Treasury sufficient to induce repayment as soon as practicable and to encourage renewed access to private capital markets and sources of credit on the more favorable rates normally available to creditworthy municipal borrowers.

This alternative avoids a bail-out of the local taxpayer at the expense of the federal taxpayer. It encourages elimination or reduction of reliance on the federal participation. It does not repel the private investor or lender from renewing its participation in a return of New York City securities to the private capital market. It does not convert the federal participation into forcing what amounts to a technical managed default with much of the real economic and psychological shock to confidence in municipal securities particularly, and debt instruments generally, to say nothing of the damage to the future of New York City.

This course seems clearly preferable to a forced stretch out, even of the obligations of the largest creditors, who should be encouraged to take part in the return of New York City financing to the private market.

The federal and state authorities should be encouraged to negotiate voluntary agreements with these large creditors and investors holding existing New York City or agency paper to exchange longer term paper for obligations maturing in the next few years. This action will relieve some part of the cash flow problem inherent in the pay off of early maturing obligations. It will also reduce the scale of the utilization of federal loans or federally guaranteed securities at the penalty interest rates contemplated.

The size and scale of the federal package to be authorized will undoubtedly be a matter of some debate. We do not feel qualified to deal with the precise numbers. However, there is one rule of thumb that has some merit. The amount authorized for loans or the limits for federally guaranteed securities to deal with New York's situation, should be sufficient to enable the City and the State and City agencies caught up in this crisis to stay out of the public capital markets for an appreciable period of time. In addition to this amount, there should be a reasonable allowance for similar problems that may occur in other states.

This breathing period free from the day-to-day crisis atmosphere will be necessary to provide an opportunity for the remedial budgetary and fiscal measures now being launched to become understood, appraised and evaluated.

It is this process which is a necessary preliminary to any re-entry of New York City securities into the public markets for private financing.

We do not believe that given the onerous conditions prescribed above, the term of the federal loans or the federally guaranteed security issues should be short. Of course, they should give the borrower the option to pay off without

penalty well in advance of the maturities along with the interest rate or premium inducement referred to above. But the very essence of most debt induced problems of state or municipal financing is an excessive reliance on short term debt. This oftentimes gives rise to cash flow problems and sometimes creates market access difficulties that threaten default where none should occur. In most cases fundamental credit worthiness or the risk of an ultimate loss to the creditor is not the case. Nor do we believe it is the case with New York.

Therefore, the federal government should be willing to lend long provided the other terms and conditions described above are satisfactorily met.

While the maturities of the direct or guaranteed loans authorized should be sufficiently long to permit an orderly working out of this financial problem, the law itself should terminate within a few years so that additional loans and guarantees initiated beyond that termination date cannot be processed.

This termination will assure an orderly review of the situation before the date of termination to determine whether conditions then existing make a continuation desirable or permit the federal government to retire from this activity.

In conclusion, having observed this New York financial crisis develop at close range over the last few months, we submit that the time for affirmative federal action has arrived.

The means ultimately chosen and the terms and conditions are the proper subject of deliberation and debate. But the ultimate outcome - a helpful and timely federal partnership with the State to manage this type of local crisis towards a constructive solution that does not reward fiscal irresponsibility but puts the local governmental authority back on the path to financial soundness - should not be in doubt.

Respectfully submitted,

C. Douglas Dillon  
Henry H. Fowler

Governor CAREY. I have correspondence from Hon. Robert V. Roosa, Undersecretary of the Treasury formerly and he's assessed this in like manner. He has a slightly different recommendation to make with regard to loans and guarantees.

In effect, he also underscores the fact that default by New York City would have unforeseeable and grave national and international consequences.

The CHAIRMAN. Thank you very much, Governor.

I submit that for the committee record as well.

[The document follows:]

ROBERT V. ROOSA  
59 WALL STREET  
NEW YORK, N. Y. 10005

October 6, 1975

Dear Mr. Governor,

You and your associates have really made impressive progress since we first began, several months ago, talking about the inescapable need for the State to exert responsibility in the New York City situation. There is no doubt that the approach to corrective action that began with establishment of the Municipal Assistance Corporation has been essential in preventing thus far an outright default by New York City. There is also no doubt in my mind that the further corrective action being taken under the influence of the new Emergency Financial Control Board is a necessary prerequisite for turning, as now must be done, to the Federal government for more direct participation.

My own contacts with financial institutions across the country and around the world have long ago persuaded me that default by New York City would be a disaster of resounding significance. A confidence crisis in the financial capital of the world could spread rapidly through the many delicately balanced economies of other countries which are still so heavily dependent upon the use of the dollar for their reserves, their trade and their investment.

This does not mean, as I mentioned in one of our meetings several months ago, that I would urge a Federal guarantee of the debt obligations of New York City, nor even of New York State. During my service in the U. S. Treasury I steadfastly resisted the stretching of Federal guarantees to cover obligations at the State or local level because I thought there would be no end to the pressures that would then be placed on the credit of the Federal government. And indeed, as Secretary Simon has so often repeated, that kind of guarantee would make the obligations of these other layers of government clearly preferable in the marketplace to the direct obligations of the

U. S. itself. But Secretary Simon should not, in my view, regard the rejection of guarantees as the whole answer to any call for Federal government involvement in the emerging New York financial crisis.

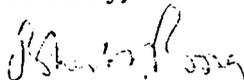
The answer, as I see it, is to deal with this situation as an unusual emergency. If time only permitted, the best approach would be through establishment of a Federal agency to cope with the succession of financial crises that have been created by the distortions which inflation (and at times even mismanagement) have brought to the American economy -- ranging from the Penn Central to the Franklin National and Lockheed and now New York City. Time is too pressing, though, to permit establishing an entire new organization, patterned after the old Reconstruction Finance Corporation, to cope with the present problem. The form of any emergency action should, however, be such that it could later be "folded into" a "Disaster Finance Corporation." Such a Corporation, under a more felicitous name, should be created with all possible dispatch once ad hoc arrangements have been established for the current New York crisis. The immediate arrangements should consist of an emergency loan program, which Congress could create within a few days, and should be under a special administrator appointed by the President. Later on, the studies being initiated by the Administration to reappraise the Federal contribution to various programs within the New York City budget, will no doubt lead to further appropriate assistance on the revenue side. But that cannot meet the maturing obligations of the coming weeks.

As I see it, there should not be a direct relationship, however, between the emergency Federal loan program and the City of New York. Respect for the principles of federalism do, I believe, call for the extending of any emergency assistance, as authorized and appropriated by the Congress, directly to New York State. It should be for the State in turn to continue employing its leverage -- and the leverage further introduced by the conditions established for Federal lending -- to assure those corrective actions that can bring a balanced budget to New York City within the next three years.

There is much more that should be said to articulate the approach outlined in these few comments. I am very sorry that unshakable commitments will keep me abroad from October 8 through November 4. I trust that some form of emergency action at the Federal level will

have occurred during this interval. As you know, if there is any way in which I can be of assistance on my return, I will certainly be ready and willing. With admiration for your courageous effort and with all good wishes,

Sincerely,



The Honorable Hugh L. Carey  
Governor of the State of New York  
1350 Avenue of the Americas  
New York, New York 10019

P.S. Please feel free to use this letter in any way that you consider helpful.

The CHAIRMAN. You gentlemen have given us forceful and persuasive argument. You say, Governor, on page 6, "I invite any member of any congressional committee, or for that matter the administration to examine the books of New York City and New York State." You invite suggestions and advice.

On page 3 you say this week you have determined accurate 3-year estimates for the city. I feel it will be difficult for the Congress to put together and pass and get enacted into law the kind of assistance measure requested. It is not impossible. What we need above all is the facts.

This committee, I think all of us recognize the great seriousness of this matter. We want to examine the facts carefully. If you will give us the draft of the 3-year financial plan, keep up to date as you get the information, pass it on; this committee will be grateful for it and we will put our staff to work on it and we will work on it ourselves.

Governor CAREY. We will do so, Mr. Chairman. We have intended to speed up our schedule anticipating that these facts were needed to be known. Had you asked for that in early summer, we could not have provided it because of the condition of the city's records. We now can do that.

That has been a vast undertaking to straighten out the records of that city to accurately reflect its condition. We can do that now.

The CHAIRMAN. We have to see what is possible here. Not what we would like to provide. What we can get through, I think, will be limited. You have suggested a guarantee.

Would it be possible to have that guarantee a partial guarantee rather than a 100-percent guarantee?

Governor CAREY. Indeed, in the Judgment of the committee, a partial guarantee would more clearly involve the city as a matter of risk and make more stressful the discipline that involves the city as a monitor with the State and Federal Government; that form certainly deserves consideration.

The CHAIRMAN. Yesterday Senator Javits suggested that the revenue-sharing entitlement of New York be used as collateral or partial collateral at least for this kind of guarantee.

How far would that go?

Governor CAREY. The total State revenue-sharing funds are \$623 million. The city share is \$230 million. Certainly the State and city share being obligated as well as other block funds such as the housing stipend under section 8 are identifiable for indemnification case for the need of defaulting of the guarantee. Those funds are recurrent.

The total revenue sharing of the country, I believe, is \$5.6 billion. If I'm correct, the recommendation of the administration is that be reenacted in that sum. The city's and State's share together would exceed \$400 million on an annual basis.

The CHAIRMAN. How much of these funds could and would, in fact, in your judgment, be made available as a pledge or guarantee or mortgage for this guarantee?

Governor CAREY. We were assuming that the guarantee would not, in effect, be implemented. So the moneys are, frankly, devoted now principally to the areas of needed local support, law enforcement to government city activities in the better handling of its sanitation and other problems. State moneys unlike the city moneys in some cases are obligated to educate. If the—the moneys are under the control

of the Secretary of Treasury to disburse the fund according to the revenue-sharing law. If they were called to back the guarantee, we would have to accommodate that.

The CHAIRMAN. What I'm getting at is I understood you to say the Federal Government would lose nothing and would make money on this.

Governor CAREY. On the taxable side and premium.

The CHAIRMAN. What assurance could we give the Congress and American public that this was a collateralized safe guarantee, that it is a matter of providing a guarantee so you can get back into the market and solve your cash flow problem? So that New York will be in a position where it will be sound. The guarantee would in all likelihood be redeemed.

Governor CAREY. We are suggesting that the guarantee flow to a State agency such as the municipal assistance corporation. The State is liable to the Federal Government.

Would the State for any reason fail to exercise in disciplinary function and monitoring under the emergency planning control board, obviously the funds under revenue sharing are under the control of the Treasury. With the guarantee called into effect the Secretary of Treasury—as the law is worded he has the responsibility in preliminary, before the moneys are expended in revenue shares to have a plan from the State or locality involved.

Our plan would have to reflect the fact that the guarantee was being picked up. Our plan would have to indicate to the Secretary of Treasury that the moneys were being made available to him and he would hold them.

The CHAIRMAN. For the record, would you and Mr. Rohatyn spell out clearly and specifically as possible how the Federal Government could be safeguarded and protected against any possible loss, calling of the guarantee which would cost the Federal taxpayers money?

Mr. ROHTYN. A default can occur for two reasons. One, because an entity becomes not credible. Secondly, it can occur even though an entity is perfectly credible, it can be denied access to the market.

In the latter case, the guarantee obviates that possibility totally. It is by definition impossible not to have access to the market if you have a Federal guarantee.

It seems to me that the areas where the Federal Government needs protection is the area of an entity that continues to run a deficit. It would seem to me if you're dealing with a revenue-sharing number in the area of \$800 million a year which the Governor mentioned and you're using that to support a total borrowing over a period of time of \$5 million, that you would use that revenue to pay down any amount of that borrowing that went into default or by reason of the city all of a sudden getting out of balance again.

The program we would try to get into play would be as the city gets into balance and MAC becomes eligible for normal financing is to run the guarantee down over a period of time as you begin putting out strips of financing on a nonguaranteed basis.

I would think that the revenue-sharing collateralization would apply to making up any deficits caused by the city itself going out of balance. It is hard for me to see by definition that if the city becomes a balanced entity how there could be a default, because the technical default—

The CHAIRMAN. There wouldn't be a default if there was a 100-percent guarantee. Let me move to something else.

I would like whatever reenforcement you could give us on the basis of this brief colloquy. Governor, you make a very strong case that New York has already taken some severe steps. You have frozen hiring. You have had a low wage increase this year.

Governor CAREY. That is the State. The State has a 3.5 percent non-recurrent pay increase to employees. The State basically froze wages. It is on a wage deferral program.

The CHAIRMAN. The Chairman of the Federal Reserve Board suggested that as a matter of redeeming New York's honor and assuring the country—this may be useful if it is practical—that New York State impose a tax that would cover half the operating deficit, perhaps \$400 million or \$500 million for 1 year in order to show that they are making this sacrifice, that they are going this far and, also, as Secretary Simon said yesterday, as an indication that this is a very stringent spartan requirement and you are not being bailed out, but you are helping yourself with a minimum amount of Government protection.

Governor CAREY. We welcome the spartan approach, but we are not prepared to sack apples.

We proposed, which is unknown to the officials involved, \$330 million of new taxes on the city of New York to cope with this condition in June of this year.

We already know that some of those taxes are counterproductive and we are losing employers and payroll and employees.

The suggestion that New York "redeem its honor" by imposing new taxes fails to recognize that New York State is the highest taxed State in the Nation, New York City the highest axed locality in the world.

To impose a tax to cover the deficit in a short term—I don't know how much the deficit of the Secretary means should be covered—

The CHAIRMAN. I am talking about Chairman Burns who said that half of the operating deficit which, as I understand it, would be—

Governor CAREY. \$800 million.

The CHAIRMAN. You had a \$10 billion budget. That would be 8 percent of your budget, \$800 million, the deficit for the—full operating deficit.

Governor CAREY. For this year.

The CHAIRMAN. That would be \$400 million. It would be 4-percent increase in your taxes.

Governor CAREY. No. Because we have only half a taxable year left.

The CHAIRMAN. On an annual basis.

Governor CAREY. We will welcome constructive suggestions from any agency that would help us.

When we hear from the Secretary of the Treasury or Federal agencies that we impose such a tax, let me say that 1 percent on the sales tax would produce that.

The sales tax in New York City is 8 percent. In order to increase that to produce \$200 million on a cash basis between now and the end of the fiscal year we would need to levy a 4-percent tax.

That means one-eighth of every dollar, 1-percent sales tax, or every citizen of New York City where we have a huge poor population.

I don't believe we can tax ourselves out of this. The imposition of

such a tax would relieve the city of the need of the discipline we are trying to impose so we don't need additional revenues which would make it unlivable.

The CHAIRMAN. I agree wholeheartedly that 8-percent sales tax is crushing and difficult. You have income tax and other taxes. We are not talking about New York City—not just the city—New York State deciding on a tax on its 17 million people.

Governor CAREY. We are taxing everything that moves and breathes in New York City. We are trying to get out of that position.

The notion we should tax our way out of this problem at the time when the Federal Government has a proposal to reduce the taxes so the Federal Government can balance the budget in 3 years seems to us to be coming from the wrong source.

Senator TOWER. You are willing to spend yourself into the problems, but not willing to tax yourselves out of them.

Now, you have been a distinguished Member of Congress. You are a very distinguished Governor. You know about the influence of the electorate on public officeholders. What we all have to consider is how the people in our respective States respond to this.

If we are going to help you out, we have to justify it to them. Right now we have difficulty doing it.

I want to cite some figures here.

1971 figures show the expenditures in New York City were greater than the combined expenditures of the next 24 largest cities.

According to the tax foundation, New York City spends at the rate of \$1,244 per capita while the average for all other cities in the country is \$295 per capita. New York City has 51 employees for every 1,000 inhabitants. In most other cities the ratio is 35 to 1,000.

According to one study, the city operates 19 municipal hospitals and has 10,000 more employees than it did 10 years ago, even though the patient load dropped 25 percent.

Educational employees approach 80,000 today. The number of students has not changed since it was in the 40,000 range.

Now, are we going to ask the \$10,000 worker in private industry to subsidize a \$13,000 worker in New York City?

You said you can't expand your tax base any more in New York City.

Governor CAREY. We don't want to ask the \$10,000 employee to subsidize New York City. Absolutely not.

Senator TOWER. I understand that. But I will tell you it will be awfully difficult for me to sell Texans on the idea to bail out New York City.

We have to be shown clearly that something will be done about it.

You know it yourself that New York has the strongest municipal unions in the Nation. I suggest they are too strong. The salaries are inordinately high in New York. I don't think you got the manned productivity that maybe you got when the salaries were half that.

I think it is time to face up to the powerful organized labor.

A man can get wage increases and fringe benefits that have no relationship to productivity. A flagrant example of that is New York City.

If this Congress agrees to do anything about bailing out New York City or establishing even a guarantee program I think that New York will have to be prepared to accept some tough strings indeed because

you know that through category all grants in aid, we do maintain strings on what communities do up here.

Congress doesn't like to return money to State and local governments without describing how it is going to be spent.

When it is obvious that New York City has been profiting, they will insist on strong strings.

Do you think the city will take it and the municipal unions will be willing if they have to to accept reductions in wages which are already inordinately high?

Let me ask this: why can't funds from the State be diverted from other purposes to help New York City if it is so important to avoid a default in New York City?

Can you think of programs in your State that can be cut or done away with and let that money be diverted to New York City?

Governor CAREY. We have done that. We have advanced \$750 million of State funds for New York City to carry it to December.

As I indicated in my testimony, the resources of the State are more limited than those of the city.

The State budget is \$1 billion less than that of the city. Sixty percent of the budget is in local aid. Forty percent of the budget is under the control of the Governor to disburse in any fashion.

This budget is applied to mental health, hygiene.

According to the rating agency, New York State has its credit rating reduced because of our extension of aid to the limit of our powers to that city.

Let me say, Senator, I agree with you that you have correctly cited the condition in New York City that brought us to this point.

Realize, please, Senator, that the very unions you talk about have participated in a wage freeze. Pensions are frozen. They are no longer accumulating increments at higher levels.

I know you well recognize that New York City got into some of its activities and actions for help to the poor, community action programs, because I was convinced by a great Texan this was a right thing to do for the cities of our country.

Lyndon Johnson told us to do these things, and we did.

Let me say as well it is very hard to compare New York City with any other.

The distinguished comptroller of the city of Houston indicated on public television that Houston has \$17 million surplus, but he said that city could be adversely affected by a default of New York.

Houston does not maintain a hospital system or school system. New York City may be doing too much.

We need a way to face some of these, as you say. We would like to see less of the money committed to welfare which costs \$1 billion of city funds for 1 million people in New York City. We can no longer afford that. We need time to work out from under those burdens.

I cannot disagree that the city spent too much. We need time to make that city accept the discipline which you rightly indicate have to be applied. We have done that in short term.

To talk about the condition as it exists and say it cannot be cured means in effect we should accept failure.

The city should be made to live up to its responsibility and we as a State are prepared to step forward and make the city accept its responsibilities.

I sit as chairman of the board to implement the changes you suggest. We welcome those.

We want the Federal Government to be a partner to see that no other city falls into the condition that New York City finds itself in and help us to cope with this.

We want those things to happen.

If we can show we can control the condition in New York, it will not spread to the rest of the cities.

Let us be an object lesson to cure the condition, but not as a failure.

Senator TOWER. Governor, I can't be sure that the city is doing everything it can to solve its problems. According to the New York Times October 8, you yourself said agreement to end a future strike gravely violates nine cities' fiscal recovery.

Governor CAREY. That is the first time an agreement was sent back.

Senator TOWER. Isn't it that the city is unwilling to do what is necessary?

Governor CAREY. The city was not a party to any negotiations. The board of education negotiated that. We have an unworkable condition—a city in regard to a costed agency couldn't control the negotiation. The emergency financial control board has no such thing as a costed agency. We have said you had to rework that contract. Yes. The employment levels of New York City with regard to similar cities in terms of ratio of taxpayers to employees has been high. Realize that we have eliminated since December of 1974 to July 11, 1975, 23,000 employees in New York City. They are no longer working. Our unemployment rate has gone to 12 percent. The fiscal plan in the works now calls for the elimination of 47,000 to 50,000 employees from a total work force of 280,000 in the next 2 years. That is unprecedented in terms of public employment.

Senator SPARKMAN. Mr. Chairman, I shall be brief.

Governor, I share the statement made by the chairman in reference to the very fine statement you have given us, both of you gentlemen. I want to ask you this: You had this up sometime recently with President Ford or at least with the administration, and I believe both the President and Secretary Simon said they could not go along with it: did they not?

Governor CAREY. They said certain things had to be done. They wouldn't deal with the city because 20,000 cities would be in the White House door. They said the State should step forward. We did. I was told by the Vice President that now that we have formed the Municipal Assistance Corporation, that is what they were waiting for. We were told as well by the Secretary when we had to adopt a balanced budget: we have done those things. We followed carefully the advice and recommendations of those officials you speak about, including the President.

Senator SPARKMAN. That is reassuring.

That is just about all I wanted to ask about. I thought you had had it up with the administration. Certainly initially it didn't seem you made very much headway.

Governor CAREY. We were somewhat confused, Senator, because it was said by the President—he mentioned a tax. He was not suggesting one. Later we heard a tax should be imposed. We do not know at what level we should propose the tax and what level it should be.

We would like to see if the tax in any form would bring forth some Federal action. We are optimistic to any suggestion except default.

Senator SPARKMAN. We are concerned with the situation confronting New York City. I think if New York defaulted it would have terrific impact throughout the country, not only with individuals, but with cities themselves that might be confronted with problems even greater because they have such—a smaller amount of financing ability to back them up.

That is all, Mr. Chairman.

Senator BROOKE. Governor, I'm sure we all sympathize with you. You have taken on one of the hardest and toughest jobs in the country and you are trying to clear up a crisis which is not of your own making. I want you to know you have sympathetic listeners to your cause. You seem optimistic about what you can do with the city of New York. You said you can make them do certain things. I wonder if you really can. You said you couldn't put on more of a sales tax because you are taxed heavily already. You are not tied to a sales tax. Are there other taxes that would help alleviate the problem?

Governor CAREY. In the package we passed in the State legislature in June, we imposed \$330 million in new emergency taxes on the city. Stock transfer taxes, bond taxes, additional taxes, real estate levy is at the limit of the constitutional level. We have every tax you can specify, an unincorporated business tax; we have city income tax. We don't want to tax ourselves into a condition where, frankly, New York becomes unlivable, because the burden of taxation falls heavily on a different population in our city. One million middle-income people have moved out of our city. One million people moved in of lesser means. They can barely afford the sales tax when they purchase shoes and clothes. We do not want to tax into dependence people among the working poor.

Senator BROOKE. I understand you do not propose any further taxation for New York.

Governor CAREY. It has been, frankly, the consensus and judgment of the private management people who are working with the control board, that further taxation imposed on New York City would be counterproductive. We couldn't get our economy back. We couldn't reduce the 12-percent unemployment. We couldn't bring business back to a city that lost 99,000 additional private sector jobs last year. We don't want to accelerate the exodus of private sector jobs out of New York City.

The CHAIRMAN. If you don't get additional taxes and revenue you have to cut back in your expenditures.

Governor CAREY. We are incorporating growth of revenues in our budget. We are not doing it at optimum level. Realistically we are programming in 2 percent growth. We hope to get more than that, but that depends on the national economy.

Senator BROOKE. I read from newspaper reports that New York City is threatened with a general strike.

Governor CAREY. That is the possibility, but the State law does not permit a strike.

Senator BROOKE. Even though your State law doesn't permit it, you agree that there is a possibility and maybe even a probability at this time that you would have a general strike. If you did have a general

strike, do you think the city or State of New York is capable of giving us reliable assurances that the Federal Government would not have to pay on these guarantees because New York's finances will be on an unsound basis?

Governor CAREY. Because of a strike, I believe that our State laws are adequate to cope with the condition where the strike won't endanger public health and safety.

I would like to point out that the atmosphere aside from the talk of the strike, among the leaders and rank and file of the municipal labor unions, has been one of cooperation. They have invested their pension fund. They accepted a wage deferral. They gave back a 6-percent wage increase. But as to taxation, yes, I served on the Ways and Means Committee, but a resident of New York who has carefully assessed the impact of taxation on our economy is sitting here.

Senar BROOKE. Before that, do you think it is wise to put the Federal Government in the position where it would have to bargain with municipal unions in order to protect the Federal loan guarantees?

Governor CAREY. No. No. On the contrary. We are asking the Federal Government to deal with the State. Let us conduct the local affairs. We will in every way—

Senator BROOKE. That is one of the problems, isn't it?

Governor CAREY. If indeed default occurs under the statute the Federal Government will be in trusteeship. I use the word "occupation." They will be dealing with those employees. I don't consider that to be an attractive prospect for the Secretary of the Treasury or whoever is appointed, to be in daily contact and trying to quell the conditions that would occur as part of a total work stoppage in New York City. I don't think that is the proper Federal role. Let us do our job. We will cope with that condition. We have and we will.

Mr. ROHATYN. On the question of taxation, I'm not opposed to studying some form of temporary tax increase in the city to alleviate the problem here. When MAC studied the situation in August before the creation of the Control Board, we came to the conclusion that the best discipline for the city is work down its deficit through management improvement and reduction in expenditures, with an expenditures freeze and tax freeze. We have in the program for the next 3 years that to resort to new taxation should not be given as an option to our elected officials in order to solve the problems of the past. One of the things you ought to bear in mind—again I speak as a private citizen of the city—that we have enormous parts of our city that look like Cologne after the war. We will have to rebuild the city at some point. We can't create a situation which would be similar to a business where you are cutting expenditures, but your revenues keep decreasing at a higher rate than your expenditure reduction, and you create a downward suction. As part of the program, it might be worth studying some temporary form of taxation as part of a major program consisting mostly of expenditure and reductions. The true discipline on the city is management. Without management reforms and really strict management reforms, this will never happen.

Governor CAREY. This may not be called a levy, but in terms of take-home pay, it is. At the instance and suggestion of the administration, we increased the fares on the mass transit system of New York City by 25 percent. For 25 percent of the people who travel that system, that is their only way to travel.

Senator BROOKE. Governor, you have addressed yourself to city taxes. What about State taxes? Have you gone as far as you can go in State taxes?

Governor CAREY. We are the highest taxed State in the Nation. Again—

Senator BROOKE. You are the highest everything in the Nation. What about the State taxes? Can you go further in State taxes? If you can't tax New York City anymore, what about the State of New York?

Governor CAREY. Well, Senator, the State of New York currently is running a deficit by reason of revenue short-falls of \$600 million. I proposed a tax program when I ended office in January 1975. The legislature in its wisdom and determination, as far as the majority was concerned on the Republican side, said no new taxes would be passed and they refused to enact any taxes. I must reckon with the condition I faced. No new taxes were imposed. Even if taxes were enacted, I doubt very much, as a matter of reality if the entire State would accept a tax that would be applied to the benefit of New York City.

Senator BROOKE. But you want us to have the votes to have the Federal Government do it?

Governor CAREY. If I were here asking for money from Massachusetts or any other State to be applied to the problem of New York City, I could not in conscience ask that. I'm asking instead for a guarantee in order to help us.

Senator BROOKE. A guarantee that may be called on.

Governor CAREY. You will be reimbursed. Then we would have to impose a tax. The guarantee would carry a premium which would be put into a fund moneys that would be there to indemnify the guarantee. By making the security taxable, there would be a 40-percent gain in revenue. Those are benefits to the Federal Government in exchange for the guarantee.

Senator BROOKE. Are there any other cities in New York that are near financial crisis as New York City is?

Governor CAREY. The city of Buffalo attempted to float \$17.5 million in general income bonds and heretofore had found access to markets and was able to fund its regular needs. It hasn't been able to do so at this time. They have an interest rate 4 percentage points higher than it has borrowing. Buffalo may have to tax its residents with a 17 percent unemployment rate.

Senator BROOKE. Buffalo may be in the same position?

Governor CAREY. No. Their budget deficit is not as high as New York City. We can handle Buffalo's situation.

Senator RIBICOFF. You are one of the most impressive witnesses I have ever heard before the Senate. Your sincerity and passion for New York and New York City is most commendable.

I would like to put a few things in perspective. What was the overall indebtedness of New York when you came to office? I want to know what the indebtedness was for New York?

Governor CAREY. The city of New York had \$13 billion debt outstanding; 6 short and 7 long.

As far as the State of New York, if we include our moral obligation bonds, moral obligation agencies, our total flow to debt was \$15 billion, depending on the extent of the borrowing that is in prospect.

Total debt of 13 and 15—moral obligation agencies do not have the full faith and credit. They are supposedly free standing. Instead of free standing, they were toppling. UDC had a debt of \$1.2 billion accumulated when I took office. It had 12-days' cash on hand. It had negative cash flow of \$1 million a day.

The total debt was near \$30 billion for the city and State.

Senator RIBICOFF. When you came to office in New York State, the State debt was in place, basically. You were stuck with it as the Governor of New York.

Governor CAREY. We have added nothing to the debt of the State.

Senator RIBICOFF. Since you have taken office?

Governor CAREY. No; we have passed nothing that would increase the debt of the State. We have tried to decrease the debt by putting a freeze on public employment, by putting an austerity budget in and cutting the department.

We are doing our best to bring the State house in order.

Senator RIBICOFF. Was that the situation as far as Mayor Beame was concerned when he came to office? That was in 1973.

Was New York's debt in place when Mayor Beame came to office?

Governor CAREY. There was indeed a sizable amount of short-term debt outstanding. As the mayor himself admitted, he added to the short-term debt in the amount of \$1½ billion during the time he was there, borrowing to meet operating expenses on the short-term, and that borrowing should not have been done.

Had the investors known the condition of the city, I doubt very much if they could have extended short-term debt and funded under the applicable laws of our country. That is an unfortunate condition.

The city was borrowing beyond its means and no one knew what the debt condition of the city truly was and how much debt it could support.

We meet the debt by insisting that the city—

Senator RIBICOFF. Today's New York Times has this statement: "Because of lawsuits and other problems, the city may not be able to use the sources of cash it is depending upon to divert default on \$453 million worth of notes maturing October 17."

That is this week.

Mr. ROHATYN. Senator, this is a standard procedure for us practically every other week. We do face—we face several uncertainties in the package leading up to a week from today. One of them is legal action with respect to the State comptroller's investment which will be argued today, I believe.

A second one is a continuing valid commitment on the part of certain of the municipal pension fund in terms of the continuity of their commitment.

The third is the possible requirement for MAC to raise another \$70 million or so as a commitment.

I would say to you that this is a fairly shaky scaffolding we are standing on. I would guess the chances are that we will make it through the 17th, but it is far from a sure thing.

Senator RIBICOFF. There is a basic problem.

You have the short-range problem, but you have a long-range problem, too, as far as New York is concerned.

Isn't it true that practically every Federal revenue sharing program, or matching program of every kind, is weighted against New York.

Governor CAREY. Very definitely, Senator.

If you want to cite the drug addiction program, we have perhaps one-half of all those hard-drug-addicted persons in the country in New York City. The number is in excess of 225,000 persons on hard drug addiction.

We get a population share of the national drug addiction program. That is weighted against us in coping with that problem which is a source of crime and breakdown of the living fabric of our city.

As far as the mandating of welfare programs, Senator, I know of none more expert in this field than you are. We don't have an option with regard to the million persons on welfare to everyone who applies for it and meets the condition.

Senator RIBICOFF. Many of the people on welfare come from States that receive from the Federal Government 80 percent of the welfare costs against New York's 50 percent.

Governor CAREY. That is correct.

If we wanted to choose Mississippi, 80 percent of the welfare costs is paid by the Federal Government, and New York gets 50 percent.

Senator RIBICOFF. The revenue-sharing formula is weighted against the urban areas that have poverty factors and high welfare costs.

Governor CAREY. We don't get the poverty and welfare factor in the revenue-sharing formula. We don't do that badly. We get the largest share on the revenue sharing of any State in the Union.

Senator RIBICOFF. Basically, most formulas that affect the cities and States are passed with the most consummate cynicism. The time has come to blow the whistle on it.

Every time a formula is put out and every time an amendment is put out, there is circulated on the desk of all Congressmen a breakdown as to how it will affect every district and every State.

The formulas are drawn to make sure you get one more than half to pass it in the Senate and House. These are voted on irrespective of the national interest, but to take care of every State, program after program.

The city of New York and New York State are on the short end because there are too few negotiations, is that right?

Governor CAREY. That is correct. I cannot be less than realistic and indicate that it has been a problem that New York has been looked on as a high-wealth State and high-wealth area.

People thought we should not be treated with generosity. Whether it is the Hill-Burton program or a program designed for housing, sometimes unworkable limitations are put in that program because they are felt to be needed.

They work against the flexibility we need in New York to cope with our own condition.

Senator RIBICOFF. What is your estimate of what New York City and New York State generate by way of tax revenues that go into the Federal Treasury?

Governor CAREY. For the city as a source we use a figure of \$20 billion that we send to the Federal Government in terms of taxation. The rest of the State, we have estimated a figure as high as \$42 billion.

To be perfectly fair, we are the headquarters of many national corporations that send their returns in from New York but their sub-plants may be located elsewhere.

On a hard basis, it was indicated by a spokesman from the White House that substantial funds come into New York City from the Federal Government and great aid was there. It included individual reimbursement, social security, and things of that kind.

Senator RIBICOFF. I saw that, and that was the most invidious statement I have ever seen in my life, because social security and welfare are things you can do nothing about. These are part of Federal programs. You are the repository of the entire problem of the United States.

What are the figures of the last 5 years? What employment have you lost and what population have you lost?

Governor CAREY. The number of private sector jobs in the last 6 years in New York State declined by 387,000. There was a corresponding increase in public employment during that period of 250,000.

In other words, the way to better New York's economic condition was to put people on the public payroll as they went off the private payroll. That was not a sound way to operate the State.

Now we need to trim the public payroll and not overtax ourselves so we can attract the private sector and hold jobs in New York.

Senator RIBICOFF. If you overtax, you will have a continuous flight of the white middle class out of New York and influx into New York of the minorities and poor and aged.

Governor CAREY. April 15, in the New York Times, there appeared an ad very well drawn, where it said, "It is April 15th, income tax day in New York State." It showed aspirin bottles pouring into a teaspoon. It said, "Get away from your headache. Move to Connecticut."

Senator RIBICOFF. That is right.

As a Senator from Connecticut who is pleased to see the growth of the State, I am concerned for New York because Connecticut is not isolated. Nor is New Jersey, or any other of the 49 States.

If you destroy New York City and the State of New York you will find that the ripple effect will be fantastic—affecting the State of Connecticut and other States in the Union as well as other nations around the world.

Governor CAREY. We recognize that, Senator. We are mindful of the taxes paid in New York City by residents of New York State.

Senator PACKWOOD. Governor, I start with a warm spot for New York City. I went to law school in NYU. I lived in an apartment on Washington Square. I liked the subway and New York Times and the theater. I thought it was wonderful that the city made available cutrate tickets for students.

I am curious about something you said in response to, I think, Senator Tower's question about the board of education—you referred to it as a covered agency.

Governor CAREY. The Health and Hospital Corp., New York City Board of Education, and some others were created as entities which supposedly are freestanding in that they are given revenues in the aggregate and they have to live within the revenues.

Senator PACKWOOD. They have to?

Governor CAREY. Theoretically. If the Health and Hospital Corp. goes over because the patient load or contract settlement was agreed by the covered organization and it turned out in practice and implementation to cost more than the parties had calculated, then the money has to come from somewhere.

That somewhere is the treasury of the city of New York.

Senator PACKWOOD. Is the city legally obligated if the covered agencies by chance come up with obligations or contracts greater than their designated revenues?

Governor CAREY. Up to now it has been. One of the powers we inserted in the Emergency Financial Control Board regards none of the agencies as covered agencies.

We have the power to review the contracts and make certain there will not be an adverse impact on the financial position of the city. Some of the consequences of overspending resulted from the fact that covered agencies exceeded the aggregate limitations placed upon them by the city budget.

Senator PACKWOOD. You're asking for a \$5 billion guarantee. How did you come to that figure?

Governor CAREY. By the way none of covered agencies could have been created in that fashion without the assent and willingness of the State government to assist the city in creating those agencies.

Senator PACKWOOD. I seldom run across a situation where an agency is relatively free to commit itself to its charges and have somebody else standing behind it. How did you come to the \$5 billion guarantee?

Governor CAREY. That's the amount that would be needed to finance the amount of short-term debt that we need to cover and take that debt long term, bring down the debt service cost so we would then pay the amounts necessary to keep the city operating. We chose \$5 billion. The \$5 billion would be a \$5 billion guarantee cover. Under that \$5 billion we would hope to move additional debt not covered by the guarantee, step by step out so we could take ourselves down range and manage what we cannot now manage, the short-term debt requirements. We need between now and July 1 roughly \$3 billion that we have not covered by the financing limitations of the MAC operation. That would be part of \$5 billion we are talking about. To cover the additional short-term needs, to get the short term converted into long term and bring down debt service the \$5 billion figure was looked at.

It's \$5 billion in guarantee. We would hope that the very placement of the guarantee would be the kind of a blessing and recognition that would change the conditions in the marketplace so we can get back to the market. More than anything else in our attempt to secure capital market, we have been hurt by the expressed attitude of the administration.

When the public hears only negatives about bailing out New York and New York being a lost city and New York going into default and that New York is being looked on as an acquisition by the Shah of Iran, it is hard in the public mind to see that New York is worthy of credit.

There has been a negative impact on our attempts to get credit by the irresponsible impact of the administration's statements.

Senator PACKWOOD. If we assist New York City, it will be for three reasons. One, we think New York is more deserving. That is not an argument we will sell in this country. Two, that the bank accepts the large portion of the debt and the banks will increase the ratios by tightening their credit. Yesterday the American Bankers Association voted 2 to 1 against any help to New York City. That covered a cross section of banks and variety of sizes of banks.

Governor CAREY. That was taken on Monday before the presentation by the Emergency Financial Control Board on Tuesday. That presentation may have changed a few minds. The bankers were asked should there be a bailout of New York City. My answer would be no as well. We don't want a bailout. We don't want money from Oregon to be placed in New York City. The guarantee would take us out of the tax-exempt market. The guarantee produces money for the treasury. The guarantee would be enforced if New York did not live up to the strict conditions imposed by the guarantee. The guarantee is little more than recognition by the Federal Government, if we adhere to the schedule we have applied or accept suggestions that may be made, that we will work our way out of our problem by paying our debts, freezing wages, stabilizing the work force. We are doing all the things we can humanly do.

Senator PACKWOOD. I understand that. I want us to justify it in the mind of Congress. The third reason—

Mr. ROHATYN. If you took a poll of the 50 largest banks of this country that handle prepondering amounts of country's financing, you would find that probably a different answer would be resultant.

Senator PACKWOOD. A third reason is that our municipalities will not be able to market their bonds or there will be an increased interest rate which would be prohibitive. I don't understand why Boston, Portland, Oreg., and Boise, Idaho, will not be able to market their bonds if New York City defaults if they have good credit ratings.

Governor CAREY. Massachusetts Housing Agency was unable to get a market with their bonds.

Senator PACKWOOD. Why is it related to New York City?

Governor CAREY. It has terrified people in regard to investing in public issue. That is true not only in Massachusetts but in my testimony I indicated a study being made up now with information on total cost in terms of interest rates because of the New York condition. Going back to the default of UDC that has produced borrowing cost of \$2 billion additionally.

Senator PACKWOOD. Mr. Solari says that if the city defaults, it can have a standard cash flow with adequate reorganization. With respect to the consequences of default—I do not share the view that default by New York would have a bad impact on the bond market of the country.

Governor CAREY. Mr. Moak is an authority and he thinks differently. Mr. Wille has indicated that 271 banks supervised by the FDIC hold New York bonds, said the banks are situated in 34 States. Those are the banks that make up the municipal offering in their locality. They couldn't do it if their credit was impaired.

Mr. ROHATYN. The New York problem has shut the State of New York out of the capital market for all intents and purposes. If that isn't a crisis I don't know what is. Credit is a tenuous thing, as you know. It is intangible but the element of uncertainty is an enormous disease that drives money to the most secure places. I think what will happen here if this thing continues is a great tiering of the municipal market where only the most assured blue chip municipal credits will have any money available to it. And a series of medium and lower-medium credits will be badly hurt. Whether that is a disaster or not is something we can discuss. That will be the impact.

Senator **PACKWOOD**. In fairness, isn't that what should happen? Shouldn't the best credit-rated cities and counties have the best ratings and the worst pay more?

Mr. **ROHATYN**. It's a question of whether you want to deny access to market because of technical and cyclical conditions. That is not the basis for economic development in this country.

Governor **CAREY**. Out of 62 counties in New York State two have triple A. They have had to pay additional interest costs. Regardless of the rating Houston, Tex., will pay more, a triple A city. State of California enjoys a triple A rating. With an offering of \$50 million they came in at 8½ percent. That is the highest rate they have experienced. Undeniably much of it rests to the uncertainty traceable to the New York condition. We want to move New York City from the municipal markets. We are asking to do that.

Senator **PACKWOOD**. Thank you very much.

The **CHAIRMAN**. Senator Williams.

Senator **WILLIAMS**. Thank you, Mr. Chairman.

Governor **Carey**, I echo what Senator Ribicoff observed—the clarity of your statement and its persuasive effect. It was just a year ago, as I recall, when you were one of us. You were then most helpful to us in developing a mass transportation program for the country. You helped persuade the Congress to adopt more equitable methods of funding for the large cities of our country. It has been a very short year for you since you were last here. Were there any early warnings of the fiscal problems you would face in the following year, when you were a candidate?

Governor **CAREY**. I might have doubled the revenue-sharing bill if I had the opportunity to do so. As far as the urban mass transit system is concerned, it is good legislation. It is needed. One of the difficulties we face is we have a rundown—frankly indescribable system of mass transportation which the people must use. If we had the opportunity to do so, we could put people to work, make capital improvements, bring down the cost of that system, reduce the energy consumption in that area, and that is what we should be doing. We can't do that because if the city is in default, I don't know how we will run that system day by day.

Senator **WILLIAMS**. That was landmark legislation that did include a partial Federal contribution to operating expenses. But again, you have to have a working system, and I gather the problems which you faced even though you have raised the fares were not anticipated—

Governor **CAREY**. It wasn't even a good decision. It was one we were given as a result of no choice. We couldn't continue the subsidy with a city that was unable to meet its daily expenditures. It was said by the administration you ought to raise your fares. Show people you are doing something drastic. We have done something drastic to the take-home pay of the people using that system. We are seeking recognition that the metropolitan area of the tristate region in which you and I live has a bad transportation problem. We can only cope with it if we can get the same kind of help as building the Metro system here in the capital area. It would save energy. It would be a good investment.

Senator **WILLIAMS**. What has happened to the construction projects for transportation which were underway?

A lot of the Federal money requires a local matching share. I wonder what you have been doing in this area of capital expenditure or what has the city been doing?

Governor CAREY. We won't be able to use the programs because we won't have the money to match. Match money for the needed improvements either in rolling stock or in improving track conditions and cleaning up the system and putting in conditions to make it secure, economic, and efficient, will be impossible because we won't be able to put up the local match.

Senator WILLIAMS. Then if the basic transportation plan isn't improved, the system gets worse, and this will have a spiral effect.

Governor CAREY. Well, the Metropolitan Transportation Authority which serves three States in its commuter rail and local transportation system, would project a deficit of \$470 million because ridership drops when fares go up.

More people go to the automobile with that ridership drop, and you know what happens then.

Senator WILLIAMS. I do. I will say everybody is demanding a greater contribution from New York. I can tell you the city of New York has tightened its belt. Parking fees, for example, have gone astronomically high.

We wish there were a way to walk across from New Jersey.

I sense a theme running through your statement that there is an attitude of punishment abroad in this land, a desire to punish the city of New York for its mismanagement.

You stated that you sense among the people of this Nation and their elected Representatives a strong feeling that New York City should be punished for its past.

You suggest there is a national policy of punishment.

I wonder if you could amplify this a bit and suggest ways that you feel this has been expressed and from what quarters.

Governor CAREY. I have heard officials in the land state that New York City frankly has been lording it over the cities of the world, and people are grinning now because it is getting what is coming to it.

I find that hard to equate with the conditions of life in New York City.

The punishment we have is 12-percent unemployment. People who want to work can't find jobs.

The punishment we have is a welfare system we know is inadequate, but which we must make available to everyone who comes by Federal law for our city and our State.

We are crippled now because of a debt condition that accumulated over the years because, frankly, the city and State were not managed effectively.

Perhaps we tried to do too much. Perhaps that is the punishment we are suffering.

We are not saying we will stop doing things for people. We have to live within our means. The means we have at this time are insufficient because we have to carry a crushing burden of \$1.6 million debt in a budget. That is our second largest item.

That money is no longer available to provide needed services.

The punishment can be seen in the scars across our neighborhoods and on people's lives. We are not yet willing to give up.

I don't know what the new punishment should be, to teach New York a lesson that we should not have lived on the Federal Government and go into the programs like the 236 program, that we shouldn't have planned ahead to build housing for those who need it, that indeed we try to do too much in building a public school system where those who did not speak our language could receive bilingual education.

These are the punishments that are visited on us for a city who tries to do too much, God help us.

Mr. ROHATYN. May I speak as a private citizen?

Senator WILLIAMS. I earlier had a note to say that the reaction which this citizen had when he read that you had faced this responsibility and accepted it, was one of the most refreshing developments of the crisis of last spring.

Mr. ROHATYN. That is flattering, and I thank you.

My reaction as a private citizen to the question of punishment is twofold.

First of all, I think from a purely dollar-and-cent point of view, for the record you ought to bear in mind we uncovered a \$3 billion past deficit. That deficit is being eaten now over the next 10 years at a rate of \$300 million a year.

We are transferring out of the capital budget expense items of \$500 or \$600 million.

The total controllable budget of the city of New York is \$3.5 billion.

Over the next 10 years, 10 percent of that amount is gone before we open the doors on a new fiscal year to make up the past deficits.

In a broader sense, from someone who lives in the city the question of punishment seems to me to raise the question whom are we trying to punish.

The people who are being punished are most of the 8 million people who live in the city.

Their crime as far as many is concerned is twofold. They are poor, and second, most of us voted for a succession of inept public officials, present company excepted.

If that becomes a problem in this country, we have to build a lot of jails.

Mr. RIFKIND. I have heard comment—I sense there has not been a full appreciation of the full significance of this emergency control board to which the Governor alluded.

When you consider that the city of New York is composed of 8 million residents and has had a long tradition of self-government and home rule and you suddenly find that its major decisions are now made by a State and not a municipal agency, the emergency control board, that the city may not borrow a dollar, spend a dollar, or commit its credit in any respect to enter into any major contract except with the approval the kind of custodianship the city is now in and the power that has been generated to bring its management and its operations into control so that this deficit can come to an end.

I think that is a tool of enormous dimensions and enormous power.

It is a real credit behind which the Government of the United States should help us.

Senator JAVITS. Mr. Chairman, I am grateful to the committee for affording me this opportunity. I would like to join the committee mem-

bers in the fine reception which has been given to Governor Carey's highly expert and spirited and impassioned testimony attributable to his great responsibility and his real love for the city and State he serves.

I join that approval of the Governor's actions here.

One thing about this punishment matter that interests me—I dealt with it yesterday when I testified.

In the first place it seems hardly American to punish other Americans. That is not the way we work. You don't even work that way in jails or with criminals. At least that is not anything we are proud of.

Yet that is the expression of the Secretary of the Treasury of the United States who used the word punitive about New York.

I hope the Congress won't think that way.

I believe, Mr. Governor, if you get any help and we get any help it will be from the Congress.

I have practically given up on the administration. I am devastated to say that. I think it is so unfair, but that seems to be the case.

Governor, as I see the situation too, the risk which we are asked to take is pretty much the judgment of the financial part of our Government. That is certainly the Secretary of the Treasury who intimates it may be better to let New York City go.

That risk would have enormous repercussions, as you can testify.

The alternative you offer the United States is a secured guarantee to carry you over a period of great difficulty and avoid that risk.

It just seems inconceivable to me that we should not do something which would cost the United States nothing except the extension of its credit. Not to take that risk would be reckless in my view.

I would like to call our attention to one point which is critical—the United States will be doing business with the State and not the city. I see somewhat of a difference between you and Mr. Rohatyn. I think it should be made clear.

Early in your statement you say I come today on a very unique mission to tell you that the default of New York City will cause not only the banks of the city and State of New York—now, Mr. Rohatyn says on page 7 of his statement I have given it as my professional judgment that an impact of a city default would inevitably lead to the default of major State agencies and possibly default by the State of New York itself.

That is a milder assessment.

I think it is really a national crisis if the State of New York will be brought down by New York City's default.

Therefore I believe either now or at some time the representation to the committee ought to be very authoritative.

Governor CAREY. In the testimony before me, to refine that point, I changed it. What it says and what I testified to is as follows: that the default of New York City will cause not only the default of the State agencies—I am referring to the moral obligation agencies which would be in default on October 15 in terms of \$89 million had we not scraped the bottom of the barrel and used the available funds in-house.

We can do that no more. The State agency has a credit need of \$1.6 billion in the period November to June and they will not be able to get to market and those notes will default.

With State agencies in default, we have seen the relationship in the public investor mind is not discrete. It shows that anything with New York on it can't get to market.

As a result, when the comptroller of the State of New York, one of the most reputable, distinguished fiscal officers in the country, took our State credit to market, which had been able to borrow at 5.29 in March—we were unable to cover our own needs except by having the State comptroller pick up his own paper through the investment of pension funds.

We didn't find our way to market. That tells us what happened before default.

If the city defaults and the State agencies cannot meet their obligation, moral obligations, I don't know how the wards in the State, villages, towns, will find access to capital markets.

It is not a question of the State being defaulted but the State will be unable to borrow because the market will not be there because no one will invest in New York State.

Therefore I say deal with the manageable problem. If not, you may be forced to deal with a State problem which the Government has never had to deal with before in its history.

Senator JAVITS. Thank you very much for that clarification. It was pointed out yesterday that even if New York defaulted—even if it defaulted on its debt service, it would still have an additional borrowing need for the cash-flow gap of about \$1.2 billion in round figures between December and March, which will be compensated for by \$830 million cash flow “surplus” between April and June.

I have predicted that that could cause enormous chaos in the city. It would cause the picking up of the pieces by the United States and could be four or five times more expensive even than the cynical estimates that we have heard.

Mr. ROHATYN. Those figures assume that next spring the State of New York can make a similar advance to the city which it made last year. If the State of New York is shut from the market, there is no way to do that.

I would like to support what the Governor was saying. Whether the State would go into default or not is conjecture because the State's needs are in the spring. There is a high risk that absent Government intervention at that time in terms of State financing, the State would be in default.

Senator JAVITS. Mr. Rohatyn, I have a question for you: The Secretary testified yesterday, if you had all the Spartan things he said you have to do, that you could have instant confidence in the investor; the theory being you could meet what you are facing on December 1, because you were taking Draconian action. The investors would, therefore, come flocking back to New York Securities. Is there any reality to that?

Mr. ROHATYN. We could lay off 50,000 people tomorrow, put the transit fare at \$2, hang the mayor of the city of New York and we couldn't make it.

Governor CAREY. If that be the course of action, I would like the same treatment as Thomas More, and you can hang me along with him.

The CHAIRMAN. Senator Cranston?

Senator CRANSTON. I want to thank you for arranging these hear-

ings, which are timely and important. I would like to ask your permission not to ask questions, but to make a brief statement. I want to underscore my strong belief that this committee, and this Congress, and the country has an obligation to help in the crisis of New York City.

As your Governor pointed out, the Wall Street crash occurred in New York but it had terrible repercussions in every village and community of our Nation, and all across the Nation and the world.

If there was a default in New York, that would have again, I believe, disastrous repercussions in all of the communities of our country and also elsewhere.

I am convinced we must act to be of assistance. I am therefore joining with the fellow Californian in a slightly different approach to this problem in an effort to be helpful. We feel your problem is our problem. The Californian I refer to is Congressman Tom Rees of Los Angeles, who is perhaps, I think, the expert in Congress on municipal finance, having worked in that field in the State legislature before coming to Congress.

The administration appears to be advising that we do nothing. It seems we can have no confidence in the advice of this administration on economic matters. We have not been doing very well in economic matters in previous decisions that have been made by this administration.

I would like to cite two examples of their contradictory and uncertain hand on the economy. President Ford suggested we cut taxes a year ago. He suggested we increase taxes a year ago. That would have been an absolute disaster. Congress took no such action. Ninety days later there was a 100-percent about-turn and the administration recommended a tax cut. The Congress followed suit and we had a tax cut. And that was the beginning of the end of the worse aspect of the recession.

Incredibly, on September 30, William Simon, Secretary of the Treasury, appeared before the Budget Committee and the trust of his testimony was against continuing the current tax cuts into next year. On October 7, Secretary Simon appeared at the White House to advocate a tax cut for greater than the tax cut than we enacted this year, indicating total confusion, absolute uncertainty, and no ability to guide the Nation, in my opinion, on the problems that confront us.

The proposal that I am making with Congressman Rees, and I introduced the bill late last night before we recessed to accomplish this, would be to amend the Emergency Loan Guarantee Act to permit the Board to guarantee the bonds of States and municipalities when those governments face financial disaster.

I would like to point out that strangely enough, after all of the concern about what a disaster guaranteeing Lockheed would impose upon the country, the facts are that it has been a good way not only to save Lockheed and many subcontractors and others from bankruptcy and many jobs, but on June 30 of next year, the U.S. Government will have earned \$22.4 million in profit from the Lockheed loan by a one-quarter percent fee it has charged for making its guarantee available to back up the Lockheed loan.

We suggest the exact same steps be taken in regard to New York with slight changes. It would seem to be a way not only to help New

York City and the State of New York and the Nation but to help balance the budget by increasing the revenues we have coming in. This is totally different from suggesting any handout or Federal loan to New York City. We are not proposing that any money be given by the Federal Government to New York City.

To summarize what this bill would do, it would guarantee the bonds of States and municipal localities. The legislation permits the guarantee of bonds issued by State and local government. It does not authorize the Federal Government to loan money to these divisions.

This is a major assertion of Federal authority into local affairs. But it is an assertion required by the extreme circumstances which confront a municipality seeking the full faith and credit of its sister cities and States in the Union to come to its aid.

I have just a bit more I want to say about it. The default of New York City on its municipal obligations would have a great and disastrous impact on the credit market and the economy of our Nation. The rate of recovery from the recession would be severely affected. State and political subdivisions in every section of the country would find it more difficult to sell municipal bond issues at reasonable rates. That is already occurring in California and elsewhere.

State and local taxpayers everywhere would be the ultimate losers by higher interest costs, delayed capital programs, et cetera. As States and cities slow down capital investments, the economy could be into a deeper downward slide.

Protecting the credit economy of the credit system is a Federal responsibility. Congress demonstrated its recognition of this responsibility on many occasions. The Federal Reserve system is the best example of our commitment of maintenance of an orderly monetary system.

The impact of a default of New York City would not be limited to our shores. We who are close to the scene may have a different understanding of the resiliency of our economy and political system than those making decisions millions of miles away.

Finally, let me say now is not the time for fiscal brinkmanship to be played by public and private interest as some are now seeking to achieve in this atmosphere.

Congress must keep its eye on the real target, the stability and smooth functioning of the world's best credit and monetary system. We should not be distracted by other issues surrounding this problem.

In closing, I would remind my colleagues of something they probably remember. When the Lockheed loan was before the committee, I offered an amendment that there be a change in the management of Lockheed because there had been obvious failures in that management. I am not suggesting any change in management in New York City where there are elected representatives who basically have been making decisions. I do suggest in the legislation that Tom Rees and I have proposed restrictions on their flexibility and tough standards in return for this assistance.

I know, Senator Javits, this is somewhat analogous to something you have introduced. I think we are going in the same general direction. I think possibly the approach Tom Rees and I are suggesting is one that would serve the mutual interests of the country and New York community in a slightly superior way.

The CHAIRMAN. Thank you, Senator Cranston, very much for your constructive proposal.

The hour is late. I would like to ask a couple of more questions. There were loose ends or they may be loose ends that only you gentlemen can help the committee with real authority.

Mr. ROHATYN, you have been quoted as saying you are running out of fingers to plug in the dike. You seem to have more fingers than a centipede has toes. I want to be sure the committee understands what you are telling us. As I understand it, it is your best judgment and I address it to each of you gentlemen that there would be no way to avoid a default of the city of New York probably by the end of the year unless the Federal Government provides assistance such as a guarantee.

Mr. ROHATYN. Senator, I'm not omniscient. I can only tell you in my judgment the likelihood of our making it well into December or into the early part of the new year is very, very low, absent Government involvement.

The CHAIRMAN. Could you say without a guarantee that at some time over the next 6 months or a year the default is clear.

Mr. ROHATYN. Based on the present situation, as I see it, I would answer that affirmatively, yes, sir.

The CHAIRMAN. I think nobody knows more about the available fingers in the dike. How about the pension funds? Can those be tapped further?

Mr. ROHATYN. Senator, we tried to mandate the State pension fund and we lost in court. We have had discussions with the Municipal Pension Fund and City Pension Fund. The total amounts available to them—I think the total corpus of those funds is some \$7 billion. It seems to me very, very difficult from a fiduciary point of view, leaving aside the question as to whether you are trying to create the first commune in the United States by this mechanism that you could get \$5 billion committed from the Municipal Pension Fund to the program and absent being able to fund out the while program, it would seem to me very questionable that this could be done.

Aside from the Municipal Pension Fund, we have failed with the national financial community and maybe other people have fingers that I have run out of.

The CHAIRMAN. You are saying Governor Carey, as I understand, that in the event there is New York City default that sometime next spring there is a strong likelihood that New York agencies and New York itself will be unable to raise money in the market and therefore would have to default.

Governor CAREY. Agencies, and the State, more obligation agencies would be unable to cover their notes or make their payment. The State itself would lack a market for its orderly sound borrowing full faith and credit. The localities, school districts, villages and towns would not have access to market. What could we do? I suppose we would have to issue some crushing burden of taxation to generate cash. I don't think that is feasible. You pointed to the possible use of funds. We tried to mandate the pension fund and the Court of Appeals found in its wisdom that that was unconstitutional.

Were we to possess a Federal guarantee, a variety of sources of credit would open up to us that are not open now.

It would be feasible then with a federally guaranteed security to attract pension funds to be invested, given the principal of diversi-

fiction and balance in the investment of those funds. What is not now available could become available with the guarantee. As a question of where to get the money, you pointed to the fact that the guarantee would make a difference.

We could attract pension fund investment.

The CHAIRMAN. If you don't get the guarantee and you do default then, as I understand it, the city under law has to meet at least certain of your financial obligations before you have money available to pay services, is that right?

Governor CAREY. That is an excellent question. The Secretary of the Treasury said funds would be available for central services. I don't know what he means or where the city will get the money to meet those services except by infusion of Federal money. We don't have access to cash. It is constitutional we must make payments in regard to the bond obligation that are outstanding.

The CHAIRMAN. Does that mean that you may not be able to pay your firemen, policemen, and sanitation workers?

Governor CAREY. I don't know where the money would come from. With inability to borrow we don't generate money except to the tax levies.

The CHAIRMAN. May I ask Mr. Rifkind?

Mr. RIFKIND. The Governor was responding to your question by giving you a fiscal answer. He said regardless of what the law may require, since the city runs a deficit intrayear with respect to its service obligations, its salary obligations, it would not have the funds if it couldn't borrow, regardless of what the law may be as to whether employees come first or the bonds come first. If there were enough to do both, there wouldn't be any problem. If you have enough to pay your bondholders but not your salaried employees, you are entering a gray area. There is no bankruptcy statute relating to municipalities. The statute you have is not designed to serve a city of the size of New York or any municipality of comparable size or lesser size. It would come to a question of how the courts would deal with the problem. There would be an intervening period of chaos. Without the proposed program, firemen, teachers, hospital employees would go without compensation. There is no question about that.

The CHAIRMAN. The city employees would go without compensation for a period of time?

Mr. RIFKIND. Without question.

The CHAIRMAN. What happens if the State of New York defaults in these terms?

Governor CAREY. As to the State agencies that are building the hospitals and university buildings and facilities for mentally retarded and the emotionally disturbed, the work stops on this project. There is a decline in value because the projects are abandoned. That is the material and physical fact which we would add to our unemployment. With regard to funding, however, we could not be the court of next resort to make the cash available to the city because our cash flow would be interrupted. Inevitably you are coming to this. In order to maintain the vital life services, what the Secretary called the central services, it appears to me you would either have to put in Federal money or Federal troops. I don't know what the cost of that would be. He can reckon that cost.

The CHAIRMAN. What you are telling us is whether the Federal Government provides a guarantee now or not, the Federal Govern-

ment is almost certain, in your judgment, to have to act to assist New York. It is simply a matter of when and how; is that correct?

Governor CAREY. Yes. And the unfortunate fact of life is, given the current condition of the Federal Code and the statute governing insolvency, there is not a workable statute for the city of New York. There wasn't even a workable statute to handle the Urban Development Corporation. We looked at it and had to discard it. We found out we couldn't work out the plan because of the variegation of holders and the remoteness and lack of identification who owed the debt. That was only with regard to \$1.2 billion. I don't know how you will find out who owns the debt of \$13 billion.

The CHAIRMAN. If the city acts with a guarantee, it is your contention that it will not cost the Federal Government any expenditure or any appropriation, but simply the guarantee that is necessary. We could monitor the progress, discipline the progress, and control the progress. On the other hand, if we do not provide the guarantee, we will, in all likelihood, have to expend substantial Federal money to assist New York.

Governor CAREY. Let me suggest, for those who are dependent, SSI people, there are Federal support programs. The aid for dependent children program is 50 percent being supported by the Federal Government. Absent money for that program and absent, or with, a standard which the courts have upheld must be maintained, I suggest that probably the Federal Government will have to reckon with undergirding the entire welfare program in New York City for the short term. That alone would have an immediate impact on the Federal taxpayers of an additional billion dollars. We in the State would struggle to keep up our share of the payment. If we can't borrow, we can't give assistance to localities. We would do our utmost, but I see a heavy burden of immediate expenditures forced upon the Federal Government as the trustee in place in control of New York City. I don't know where that money is coming from under present programs.

Mr. ROHATYN. Senator, I think you have other immediate potential, theoretical costs here. If you take the total of city, State agencies, and State obligations as \$30 billion and if you had a default of those three groups of entities which require a writedown of 50 percent throughout the country and most of the banking system, you have a \$15 billion loss that would run through the economy. I can't say what everybody's tax treatment is. Assume we run a 50-percent tax rate across the figure, which is probably an incorrect and crude figure, you could have a \$7.5 billion tax reduction as a result of that simply by a recognition of losses throughout the system.

The CHAIRMAN. The Federal Government would lose how much?

Governor CAREY. \$7.5 billion.

Mr. ROHATYN. If those figures are correct, it could lose \$7.5 billion in tax receipts over a period of time. They are crude figures.

The CHAIRMAN. Gentlemen, thank you very, very much for superlative testimony. You have been most enlightening and helpful.

Senator CRANSTON. I want to compliment you, Governor Carey, on your statement. I think it is a magnificently stated, deeply held presentation of the problems that you as Governor face. I'm delighted to find what you recommend is close to what I have decided should be done.

[Prepared statements of Governor Carey and Mr. Rohatyn follow:]

STATE OF NEW YORK  
EXECUTIVE CHAMBER  
HUGH L. CAREY, GOVERNOR

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FOR RELEASE:  
10 A.M., FRIDAY  
OCTOBER 10, 1975

TESTIMONY BY GOVERNOR HUGH L. CAREY  
BEFORE THE SENATE COMMITTEE ON BANKING,  
HOUSING AND URBAN AFFAIRS, DIRKSEN SENATE  
OFFICE BUILDING, WASHINGTON, D.C., FRIDAY,  
OCTOBER 10, 1975, 10 A.M.

I come to you today with as great a sense of urgency as any Governor ever has felt in the history of this country. As a former member of Congress, I know fully well how frequently you are asked for financial assistance, for tax breaks and for the means to enhance wealth or credibility. I come today on a very unique mission--to tell you that the default of New York City will cause not only the bankruptcy of the State and City of New York, the devastation of 17 million people, but unforeseeable national consequences of such an adverse and sizeable nature that we have no choice but to prevent them.

I sense that among people in this nation and their elected representatives there exists a strong feeling that New York City should be punished for its past.

However you feel about New York City, a national policy of punishment will only hurt eight million innocent Americans who live in New York City and another four million Americans who depend on that City for their livelihood.

What did any of those Americans do to deserve to suffer the uncertainty, the chaos, the slow death of their City which would result from a default?

I cannot stand here today and deny that New York City tried to do too much for too many and that imprudent management was certainly part of its problem.

But I do not wish to waste any further time discussing misconceptions about mismanagement or policies of punishment, or apportioning blame.

I am here today to promote understanding, I am here to seek recognition for all the State of New York and the City of New York have done in recent months to repair the City's past and to prepare for its future.

Last Spring, when investor confidence was so severely shaken that the market for short-term City debt closed down, the State of New York advanced nearly 800 million dollars of State aid payments to the City in order to provide time for an orderly review of the alternatives.

I felt it was my duty and obligation to keep the White House, the Federal Reserve and the U. S. Treasury informed of the exact nature of the City's financial problems and the severe consequences a default would have on our State and Nation.

I also sought advice and constructive suggestions from those officials and they urged us to have the State step forward; they said that they would only deal with the State in developing a possible federal solution. So on the advice of the highest federal officials and on the advice of highly qualified financial experts in our own State, we created the Municipal Assistance Corporation--Big MAC.

Part of the City's problem at that time appeared to be an excess supply of short-term City debt, so MAC was designed to refinance this short-term debt on a longer-term basis. To secure MAC obligations and to increase investor confidence in the political will behind this effort, an important part of the City's revenue stream was diverted to MAC. Finally, to restore investor confidence in the political will and the managerial competence of City government, MAC was mandated to work with the City in instituting managerial and budgetary reforms which would restore the City's fiscal integrity.

Even after we accomplished all this, we were told by federal officials that all we had done was to exchange short-term debt for long-term debt. They urged the State to do more.

Then over the summer it became apparent that the market had not recovered from its qualms about New York City. For the sake of that market and for the sake of the City, we determined we needed more swift and more dramatic action.

Therefore, early last month I called the State Legislature into Special Session to consider the actions I felt were necessary to save the City from default.

The Legislature adopted my proposal for a commitment of State and pension funds to meet the City's financing requirements until December of this year. We appropriated \$750 million of State funds to help the City. We put the credit of the State of New York on the line. It was a difficult decision, but I believe we did the right thing.

The Legislature also adopted my proposal mandating the City to achieve a balanced budget in the fiscal year ending June 30, 1978, and to show substantial progress toward budgetary balance in each of the two intervening fiscal years. To assure the achievement of these goals, the Emergency Financial Control Board was established, putting the Governor and the State Comptroller, the Mayor and the City Comptroller, and three qualified management leaders from the private sector in charge of the City's three-year Financial Plan.

The Board has the power and the responsibility to assure a restoration of the City's fiscal integrity. It will use that power to achieve fiscal integrity. And with that integrity should come a restoration of the City's credit worthiness in the market in due course.

The City must submit to the Board a three-year financial plan showing a balanced budget in the fiscal year beginning July 1, 1977, and substantial progress toward a balanced budget in the two intervening fiscal years. The Board may approve, disapprove or modify the financial plan to achieve the goal of a balanced budget.

To enforce the execution of this three-year plan, the Board has the power to review and approve or disapprove a wide range of City contracts. It may suspend municipal employee wage increases to the extent it decides is necessary to achieve the objectives of the financial plan.

All City revenues are diverted to the Emergency Financial Control Board which then disburses these funds to assure compliance with the financial plan. In the event revenues in the Board's fund are not sufficient to meet expenditures authorized by the financial plan, the Board is required by law to make payments on a schedule of priorities which protects creditors first.

In the thirty-three days since the Legislature approved my special plan, the Emergency Financial Control Board has proved it can meet the challenge of returning New York City to fiscal integrity.

Three outstanding members from the private sector--William Ellinghaus of the New York Telephone Company, Al Casey of American Airlines and David Margolis of Colt Industries--have been appointed to the Board. We have met six times, and a spirit of utmost cooperation, understanding and unity had prevailed at each meeting. Each member fully appreciates the Board's critical mission.

We have determined accurate three-year revenue estimates for the City. At this week's meeting, a week ahead of schedule, the Board received the first draft of a three-year financial plan from the City. The purpose of that plan is to reduce City expenditures to match its revenues so that when the City returns to the credit market, it will be a good investment.

We are in the process of reviewing City contracts and collective bargaining contracts. We are reviewing the City's tax revenues to determine which taxes would be extended, which should be eliminated as counter-productive and which should be adopted as substitutes where necessary.

In short:

--In a city with the strongest municipal unions in the Nation, there is a wage freeze.

--In a city with the largest construction industry in the Nation, there is a freeze on new capital construction.

--In the financial capital of the world, a State agency completely controls New York City's access to money.

These actions, though harsh, are not inconsistent with the steps I have had to take since the day I took office:

--The actions we took to save the Urban Development Corporation.

--A State hiring freeze which has resulted in more than 5,800 fewer employees.

--One of the lowest collective bargaining settlements in history in which 140,000 State employees were held to a 3.5 percent increase.

None of these actions is inconsistent with what is happening in New York City.

Last month, both the Democratic and Republican leadership of the State of New York faced a most difficult decision. It was not easy to decide to put the credit of the State of New York on the line to give New York City time to survive. But both the Democratic and Republican leadership of our State government felt we had no other choice.

Now our State's resources are stretched to the limit. Now, I must tell you, as a State, we have done all we can to help New York City.

The State of New York cannot guarantee the securities of New York City. We have neither the resources nor the power. In fact, our State government is smaller than the government of New York City.

Now we seek recognition from the Federal government for what we have done. We need and we deserve federal assistance. We are not asking for a handout or a bailout. We are asking for a sensible solution--a limited guarantee of the securities issued by the Municipal Assistance Corporation--the State financing agency for the City of New York.

The securities covered by the guarantee should be of a relatively long maturity--at least ten years--so that with a guarantee on bonds with a principal amount of five billion dollars we can effectively handle New York City's remaining short-term debt. With the effective action of the Emergency Financial Control Board and this federal guarantee, we will make certain this is a non-recurring problem.

We are proposing that these bonds be taxable for three reasons:

--To prevent the downgrading of other taxable securities because a tax exempt and guaranteed security would be superior to every other security in the market.

--The removal of New York State from the tax exempt market would benefit other municipal borrowers in the country.

--The taxes on the bond's income would yield revenue for the federal government.

The City's Emergency Financial Control Board will see to it that the City achieves a balanced budget so that the guarantee is never drawn down.

If we get the federal assistance we need, I can promise you, that after 1977, New York City will never again have to borrow beyond its means to meet its operating expenses. And I promise you that in the mechanisms and institutions I set up to meet this goal, I will not only insure that this will be true during my administration, it will have to be the policy of future governors who may succeed me.

One of the best ways we have of preventing major errors in foreign policy is a sound system of intelligence.

A lack of intelligence information caused a great national disaster on December 7, 1941.

I come before you today with intelligence information which you must use to prevent an Economic Pearl Harbor on December 7, 1975.

While I can't predict for certain all the severe national and international effects of a default by New York City, I can tell you what problems the situation has already caused in our State.

Our major State agencies--agencies with sound, secure revenues and the certain ability to pay debt service--are in severe danger of default because of the crisis in confidence in the Nation's municipal bond market.

The New York State Housing Finance Agency which has financed 800 projects worth 5.8 billion dollars over the past 15 years cannot find a market for its sound securities.

Neither can our State's Dormitory Authority, Environmental Facilities Corporation and our Medical Care Facilities Finance Agency.

What will happen to 1.6 billion dollars worth of projects underway by these State agencies in New York?

I can answer that.

Our State will be spotted with empty monuments to default, partially built classrooms, dormitories, public and private hospitals, mental health facilities, day care centers, nursing homes, water pollution control facilities, and housing for low and middle income families, to name a few of the ongoing projects--will forever stand as only steel and concrete.

Our sick, our elderly, our children in need of education, our working mothers and all of our citizens will forever be denied the vital services those facilities were designed to provide.

Billions of dollars in capital will be wasted.

More than 53,000 workers who depend on these four agencies for their livelihood will be sent to the unemployment lines.

So I must ask, what will happen to the projects, the services, the capital and the jobs in 33 other states with similar agencies?

New York State's localities and sewer and water authorities need to accomplish 1.1 billion dollars of their traditional, regular borrowing between now and March.

Yet local banks which in the past bought their paper without question because that paper was sound, have now turned their backs and closed their doors.

So I must ask what will happen to local units of government across our nation who must have access to the credit market to meet their cash flow needs and provide services to their citizens?

Hundreds of New York State School Districts will need to achieve 1.2 billion dollars in traditional borrowing between now and next June.

Local banks are closing their doors to our school districts.

This week I received a letter from the East Islip School District in Long Island.

The finances of that district are and always have been sound and secure.

That district needs to make three offerings of securities totaling 5 million between now and January 1976.

Local banks in their words "are not willing to deal with us at any price."

On October 1, the school district was able to obtain a loan of \$800,000 for 30 days at a 11.15 per cent interest rate. So I must ask how will the children of New York State receive their education in the future? What will happen to the future education of all the children in our nation as the disease of default sweeps our country?

We know that most of New York State's paper is sold in New York State. But who owns New York City? Who will be hurt if New York City defaults?

Individuals with their life savings invested in New York City -- not only banks -- but business in every state of the nation own New York City. So we must ask ourselves, what will happen to businesses whose future depends on loans they have secured with New York City paper as collateral?

The Congress of the United States must ask itself:

What purpose is there now to the National Housing Act passed last year?

For that legislation assumed localities would have access to the credit market at normal interest rates.

What will become of that legislation with the municipal credit market in shambles?

The Congress must also examine the effects of New York City's problem on its local revenue sharing programs.

I know of one respected economist who estimates that skyrocketing municipal interest rates could cost localities across this nation up to 3 billion dollars. That would negate one-half of the federal general revenue sharing funds. What federal plan is there to help the citizens in localities across this nation faced with increased local taxes to pay those interest costs?

If the purpose of non-intervention on the part of the federal government is to teach New York City a lesson and force it to economize, there is a sense in which this policy might turn out to be both ineffective and extremely costly to other governmental units.

What motive will there be for the city workers to continue their self-sacrifices and to provide vital services with the city as a trustee of the federal government?

A city in default is a demoralized city. Will a city under federal occupation and control have any motivation to pay its debts?

Those governmental units that have issued long-term bonds at higher interest rates and do not default, on the other hand, will be forced to continue to pay these higher interest rates over the life of the bonds. The question is, will most governments be willing to do this after there is a New York City default? Or will they see default as an accepted way to unload their debts? Do we, as a nation, want to set national policy which encourages local government to throw in the sponge, to give up trying?

New York wants to pay its debts, we want to attend to the errors of the past. We simply seek recognition for all we have done.

I am the first to admit that under the system New York City used to keep its books, it was difficult, to say the least, to get proper information on the city's financial situation. Now, the books are not only open, the figures are sound and dependable.

I invite any member of any congressional committee, or for that matter, the administration to examine the books of New York City or New York State. We invite constructive suggestions and advice.

It seems I have raised as many questions as I have answered today.

The fact we have no answers to the questions points to the fact we need in our government, an orderly system in which we can find these answers so we do not have to speculate on the unforeseeable effect of default on our nation's economy. Whoever is willing to stand up to the questions I have raised today will never again be able to say that the effects of a New York City default would be contained within the borders of our city or state.

Whoever is willing to stand up to these tough issues will never be able to deny that New York City's problems are national, indeed international, in scope and effect. And no member of the United States Senate will be able to overlook the certainty, that if New York City is allowed to default, the financial problems of New York City will be in his state very soon.

The choice before the United States Congress is clear:

-- Either a limited guarantee of the securities of New York State's bonds which will cost nothing, which will, in fact, add revenue to the federal treasury;

-- Or a default of New York City, which I am certain would be the most costly mistake in the history of this nation -- in dollars, in human suffering and in the erosion of our democratic institutions.

I cannot deny that there is a contagion in New York which is about to sweep across the nation. Don't kill us because we are ill.

We are asking for your assistance so that we can cure ourselves and contain the contagion. I do not relish the prospect that on our nation's bicentennial anniversary, the city which was this nation's capital in 1789, may be occupied by the federal government. Nor do I look forward to the slow yet certain death the financial, cultural and entertainment center of the world would suffer if it is denied federal assistance and allowed to default.

## STATEMENT OF FELIX G. ROHATYN, GENERAL PARTNER, LAZARD FRERES &amp; Co.

Mr. Chairman: My name is Felix G. Rohatyn. I am a general partner in the Investment Banking House of Lazard Freres & Co. I am here today in my capacity as Chairman of the MAC to ask for your support for a Federal program to prevent the unnecessary default of the City of New York. I believe that both from a banking as well as a human point of view this is a tenable position. But let me first, as an investment banker, talk about the City. There I am concerned with certain issues:

1. Whether New York City is financially sound.
2. Whether it is viable from a management point of view.
3. Whether it can provide its service at an acceptable cost.

When Governor Carey asked me in late May to assist on a panel to help resolve a mounting crisis, it was apparent that none of these criteria were being met.

The City had no credible financial plan to get a balanced position.

The City's management could not demonstrate that it could deliver the services required of it with the money available to it.

The City's management was not credible to the public and to the institutions whose support was required to keep the City going.

We recommended creation of MAC. The Governor accepted it. And it provided the bridge which enabled us to walk, or stagger, from June to October. At least we can point with a certain amount of pride to the fact that, as the Governor has pointed out, enormous strides have been made, and we have so far prevented a default.

I believe that today we have the main elements required to put any economic unit back on its feet. We have fiscal control, exercised by the Financial Control Board to determine how much money the City has available to it and which sees to it that the City spending is held within those amounts. We have the beginnings of a restructuring of the operational management of the City. We have a financing vehicle in MAC.

I think you would all agree that as of today there is a plethora of talent—of business talent, of management talent that is being brought to bear on City management practices and personnel. This talent is in for the duration.

I would be less than truthful if I told you that everything today is in place to run the City as I and investors all over the country might like to see it run for the next ten years. But the process has started and will not be stopped. The MAC legislation and the emergency legislation passed last month required that the City's budget be in balance by the fiscal year beginning July 1, 1977. The men now involved are erecting a fiscal fence around New York City—they know how to read balance sheets, read profit and loss accounts, judge management methods and systems.

The history of the past few months and specifically negotiations which involved MAC with the municipal unions have convinced me that the majority of the City's union leadership is anxious to see more efficient City management.

They see it as the only way for the City to survive and for a smaller stabilized work force to be secure about its future.

The City will get into balance because it has to. Period. Management will determine whether the City is a livable place or a fiscal success but a social failure.

All of you know that any reorganization takes time. All of you also know that it is far better, economically, professionally, and humanly, to permit a sick situation to be cured over a period of time than to chop it to pieces. The cure involves imposing stringent conditions on the City. If I am right that the control mechanism is in place and the beginnings of sound management practices have been initiated, then the need is for a financing mechanism to make it happen within the statutory three-year period. From the outset we perceived MAC as the appropriate financing mechanism. However, while the mechanism is sound, the markets have closed down, not only around the City but on MAC and the State.

Most experts agree today that neither MAC nor the State of New York full faith and credit obligations are poor credits.

What they are facing today is non-marketability which as you know is a quite different matter.

However, lack of marketability can be as lethal as poor credit. I believe that performance to date and the security behind MAC entitles it to a market at reasonable interest rates.

However, I question whether there is anything that we can do at this point to open the market in the near future.

The problems we are facing is also the result of a more profound and basic economic dislocation.

Whether a dramatic or conventional form of fiscal discipline is involved, one fact is clear. A severe capital shortage is looming over the next decade or two.

This shortage is going to affect every person in this room and every city and state to which you are committed. It is going to put significant restrictions on this country and will create greater and greater requirements for efficiency on the part of elected officials to enable them to deliver services to their constituency.

Politicians will have to learn not only in New York City, but all over this country that organizations requiring large amounts of capital must discipline themselves in order to have that capital made available.

Looking back over the last fifteen years it is easy to say that the problems of the City have been caused by mismanagement and by fiscal gimmickry. It is easy to say and it is undoubtedly true. It would be equally true to say that money was made available to the City in ridiculous amounts and on ridiculously easy terms. The financial community, of which I am a member, has to bear its share of the blame for what happened to the City.

Financing vastly beyond the limits of prudence was obvious to even the unsophisticated. What happened in New York City was written on the wall. It was inevitable that sooner or later the crisis would occur and the political process failed in preventing the crisis.

Certain of New York's problems are probably unique to it—but the fact remains that New York City is not all that unique. I don't believe that most of you sitting here as you think it through will feel that your cities and your states are all going to be immune from these problems. What is the answer for us then? Over the last four months since the creation of MAC we have raised approximately \$2.5 billion dollars with the superb support of the N.Y. banking community, with additional support from other local institutions, and with practically no support whatsoever from out of state financial institutions. The Governor has told you what actions have been taken.

The existing financing may see us through the beginning of December although there are uncertainties even during this period. If we do reach December 1, we will have raised close to \$4 billion, involved the state to the extent of \$750 million, and scraped every known resource available to MAC, the City and the State. By December 1st there may be some avenues still open to us in a limited way but absent to an assured financing mechanism that would enable us to fund out our three-year plan, the odds against our winning are exceedingly long.

When, in August, it became apparent that the markets for MAC securities would be closed to it in September and the Governor asked for recommendations involving possible State and/or Federal action, we were mindful of the proposition that no Federal involvement could be contemplated until the State itself had made a major commitment both in terms of the control of the City's finances and in terms of the State's financial involvement itself. The legislation which the Governor asked the Legislature to approve contained both elements of this approach. The commitment of \$750 million of State funds spread over a three-month period of time seemed to us to include a significant involvement of the State but in the light of the State's resources and history, did not seem to threaten the State's integrity significantly more than it was already threatened by a possible default of the City of New York. The markets have, however, closed upon the State as well as upon MAC, and as well as upon creditworthy State agencies, such as the FHA. Without the State Controllers' commitment of State Pension Funds to acquire the \$250 million of State Notes prior to October 17, the State would undoubtedly be unable to fulfill its commitment to make \$250 million available to the City as part of the fiscal package at that time.

Although a default is technically defined as the failure to pay off a debt as it becomes due, in my judgment, had the State failed to meet its commitment to make \$250 million available to the City in October, as it is committed to do legislatively that would have meant an actual default in real terms, quite as serious as the failure to meet a debt maturity as it became due. The present financial crisis of the City of New York, even after taking into account significant action taken over the past three months by City, State, financial community, and the private sector, has successively shut off access to markets of City, MAC, State agencies and, now, the State of New York itself. The total amount of indebtedness involved of these entities is close to \$30 billion, or about 15% of the total municipal debt outstanding in the United States.

Many arguments have been heard on either side of the question of the impact of a default of the City. I have given it as my professional judgment that an impact of a City default would inevitably lead to default of major State agencies, and of a possible default by the State of New York itself. I believe that the impact of such a series of defaults is not containable without major cost to the economy, and to our international position. I believe that domestically the economic recovery would be seriously damaged and that in New York City itself an irreversible exodus of corporations and businesses would condemn the City's tax base to a fatal downward spiral. Abroad it would seem to me that such a failure would be attributed to either a fundamental structural failure of the capitalist system, or to be the result of divisions within this country so profound as to paralyze its will to act.

I realize that these are judgments, and that human judgment is subject to error. It seems to me, however, that the assumption of a major needless, and I emphasize needless, economic and social risk in the name of fiscal prudence, is neither good logic nor good policy.

We are looking for Federal involvement to maintain an orderly market in our obligations, so that we can bring our program to a successful conclusion and pay our debts 100 cents on the dollar. There are several approaches that could accomplish that purpose and we are open to different possibilities. As far as MAC is concerned, our choice would be for a program of Federal guarantees to MAC bonds, with taxable interest on those bonds at the time the guarantee goes into place. We do believe that only State agencies such as MAC, should be eligible for such Federal guarantees and that approval by Federal authorities in addition to the Emergency Fiscal Control Board of the City's three-year fiscal plan would have to be involved. We believe that an appropriate insurance premium and the possible pledge of Federal revenue sharing to protect the Federal Government would be appropriate steps for discussion.

The hour is very late. A financial virus has existed in New York and we want to keep it from contaminating the rest of the country. You have witnessed the spread of the virus in spiraling municipal interest costs and deteriorating investor confidence. Assured access to markets while the City gets into balance is the best way to vaccinate the rest of the country against this virus.

At a time of early economic recovery a massive default anywhere is dangerous. A default of mammoth proportions, involving City and State, that was both unnecessary and avoidable would be an inexcusable tragedy.

The CHAIRMAN. The committee is going to proceed.

The next witness will appear now and proceed as far as you can.

The third panel will appear this afternoon.

The next witnesses are Brenton Harries, Paul Markowski, Wallace Sellers, William Solari, and Edward Kresky.

**STATEMENTS OF BRENTON W. HARRIES, STANDARD & POOR'S CORP.; EDWARD M. KRESKY, WERTHEIM & CO., INC.; PAUL J. MARKOWSKI, ARGUS RESEARCH; WALLACE O. SELLERS, MERRILL LYNCH; AND WILLIAM J. SOLARI, DONALDSON LUFKIN**

The CHAIRMAN. Gentlemen, we are very grateful to you for appearing. You are the outstanding experts in the country on municipal bonds and on the consequences of whatever action the Federal Government may take or may not take.

You have concise statements. We would appreciate it if the statements could be abbreviated under the circumstances.

Do proceed and give us as much information as you can. Your statements will be printed in full in the record, so we can question you.

Our first witness will be Mr. Brenton Harries.

Mr. HARRIES. I would like to emphasize that the immediate problem of New York, the city, State and its agencies is one of cash flow. We believe that the credit problem is one of cash flow. Our credit ratings attempt to measure ability to repay debt.

An integral part of this analysis is a judgment as to the ability to borrow.

In the case of the city and New York State agencies, they have lost the ability to borrow to meet maturing short-term debt. This makes the problem of default on short-term notes an immediate and constantly recurring need.

May I interject? This is a different problem from what the Governor was talking about. New York State does not have volumes of short-term debt that must be met by borrowing again. New York State liquidates its short-term debt primarily from revenues. We do not look for default of the State itself. It does not have huge amounts of short-term debt that have to be met by selling new debt.

Normally, borrowing is for capital improvement, and I emphasize that in the case of the city the borrowing is for debt repayment and inability to borrow triggers immediate default.

It is our belief that outright default by New York City would shut down completely—for a prolonged period—the ability to borrow for various New York State agencies, and that this in turn would make it impossible for New York State to tap the note markets as it has historically done for many years to provide advance payments of State aid to New York State school districts, towns, and counties.

I would like to point out something that indicates the degree to which the market has recognized the erosion of values totally out of proportion to the actual risk. I appeared on the "Wall Street Week" program a few weeks ago. I received many letters. One was from a man who purchased a 6¾ percent coupon bond of Battery Park City Authority maturing in 2014. He paid approximately 100 or \$1,000 per bond. Because market psychology says everything about the bond is wrong, that is, the authority is located in New York City, New York State, and is backed by the "moral obligation" of the State, it has three strikes against it. The bond today is quoted at 45 or \$450 while, in fact, behind each bond there is still some \$700 from the original bond proceeds invested in U.S. Treasury obligations.

For another example, New York State 5.37-percent notes sold last May and due to mature on March 31 of next year—just 5½ months from now—are currently being offered at an unheard of discount of seven points. This is equivalent to an annual yield in excess of 20 percent.

My third reason for advocating Federal involvement is because of the Federal Government's crowding out of borrowers in the capital market by the huge demands being made to finance the Federal budget. In the last decade the Federal Government has preempted one-quarter of a trillion dollars in the Nation's money market. Surely it must share some of the responsibility for allocation of capital and rising debt service requirements.

The legislation would provide for direct loans to the State or an agency set up by the State as a conduit by the Federal financing bank.

The rate of interest should be whatever the Federal financing bank has to pay, plus an amount to cover service charges—perhaps 1 percent. The rate, in any event, should not be a bargain to the State.

Mr. Chairman, in the interest of time, I will pause.

[Complete statement follows:]

STATEMENT OF  
BRENTON W. HARRIES, PRESIDENT, STANDARD & POOR'S CORPORATION  
TO THE U. S. SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS  
WASHINGTON, D. C. - OCTOBER 10, 1975

The fiscal crisis in New York, the City, the State, and its various agencies, has been well documented and I will not dwell on it further other than to say that the immediate problem is one of cash flow. Our credit ratings attempt to measure ability to repay debt. An integral part of this analysis is a judgement as to the ability to borrow. In the case of the City and New York State agencies, they have lost the ability to borrow to meet maturing short-term debt. This makes the problem of default on short-term notes an immediate and constantly recurring need. Normally, borrowing is for capital improvement, and I emphasize that in the case of the City the borrowing is for debt repayment and inability to borrow triggers immediate default. It is our belief that outright default by New York City would shut down completely - for a prolonged period - the ability to borrow for various New York State agencies and that this in turn would make it impossible for New York State to tap the note markets as it has historically done for many years to provide advance payments of State aid to New York State school districts, towns and counties.

The State has set in place a financing mechanism called the Municipal Assistance Corporation and a control mechanism, the Emergency Financial Control Board, to oversee the budgetary and financial affairs of the City. These mechanisms appear sound and well conceived through the dedicated efforts of the Governor and leading citizens. However, this new system requires time to become fully operative in managing the City's finances. But time is running out, and the City's short-term debt matures each month. In our opinion, it is an absolute certainty that New York City will default without the infusion of cash to repay maturing debt and

the only avenue open to the City is the State and the market for the State notes also has now closed.

I believe the intervention of the Federal government is absolutely essential to provide the State sufficient time to regain the credibility necessary so that the State, its agencies and the City may once again return to the public debt markets.

There are three specific reasons why the Federal government should become involved.

First, there has been a massive erosion in the value of municipal securities nationwide far out of proportion to the actual risk. This adverse market psychology has caused many bond issuers to pay abnormally high interest rates. For example, in the secondary market for municipals, bonds of the Battery Park City authority provide a horrendous example of market erosion. I received a letter from an investor who purchased this bond in 1972 when it was issued at a 6 1/8% coupon maturing in 2014. He paid approximately 100 or \$1,000 per bond. Because market psychology says everything about the bond is wrong, i.e., the authority is located in New York City, New York State, and is backed by the "moral obligation" of the State, it has three strikes against it. The bond today is quoted at 45 or \$450 while, in fact, behind each bond there is still some \$700 from the original bond proceeds invested in U. S. Treasury obligations. For another example, New York State 5.37% notes sold last May and due to mature on March 31 of next year - just 5 1/2 months from now - are currently being offered at an unheard of discount of 7 points. This is equivalent to an annual yield in excess of 20%!

Secondly, there will be a major negative impact on the entire economy of the State if access to the borrowing market continues to be denied the State and its

agencies. Failure of the Housing Finance Agency to float notes to finish various projects under construction will harm the state's economy while jeopardizing the completion of needed facilities. In addition, the State historically enters the short-term market in the Spring to provide funds to cities and towns for welfare, education and social services. Failure to obtain these funds would trigger defaults across the State. May I emphasize that I am referring constantly here to the inability to borrow. The bonds of the State continue to be well secured and the bonds of the Housing Finance Agency are well secured by revenue-producing, completed projects.

My third reason for advocating Federal involvement is because of the Federal government's "crowding out" of borrowers in the capital market by the huge demands being made to finance the budget. In the last decade the Federal government has preempted one quarter of a trillion dollars in the nation's money market. Surely it must share some of the responsibility for allocation of capital and rising debt service requirements.

How should Federal money be transmitted to the State? I apologize for being unable to keep up with the various legislative ideas emanating from the Congress. I recognize in several of the Bills pieces which fit my proposal so let me state my ideas briefly.

The legislation would provide for direct loans to the State, or an agency set up by the State as a conduit, by the Federal Financing Bank. The rate of interest should be whatever the Federal Financing Bank has to pay plus an amount to cover service charges - perhaps 1%. The rate, in any event, should not be a "bargain" to the state. The loan should be administered with very stringent budgetary and payment conditions and the screen to examine the qualifications should include the following criteria:

1. The State should have exhausted all other possible remedies and be no longer able to obtain credit from any other source.
2. There must have already been passed legislation within the State for complete takeover of the afflicted local government's finances, such as the Emergency Financing Control Act in New York State.
3. And, lastly, there should be the absolute and real threat of imminent default.

In order to assure continuing State bond holder protection, the Federal loan should be subordinated to the first lien of the State's general obligation bond holders. I believe this step is necessary because of various state constitutional requirements of voter approval to incur additional general obligation debt. It would not obviate the necessity of the State providing a precise plan for repayment of the Federal loan within a set time period. Additional Federal sanctions should be imposed as deemed appropriate.

The CHAIRMAN. Mr. Kresky.

Mr. KRESKY. Thank you, Mr. Chairman.

I'm speaking in two capacities as vice president of Wertheim & Co., Inc., and I'm a member of the board of the Municipal Assistance Corporation for the city of New York.

The fiscal crisis facing New York City has been building up for a number of years. The roots of the problem are widespread and need not be rehashed again today. That the city of New York has lived beyond its means is self-evident. That the city, after recognizing the fact that it was drowning in its short-term-debt problems last year still failed to act vigorously enough to curtail expenditures was most unfortunate. This, of course, contributed to the credibility gap regarding the city's abilities of self-discipline which, in turn, manifested itself in the closing of the money markets for New York City.

In June of this year the State of New York attempted to aid the city through the establishment of the Municipal Assistance Corporation, empowered to stretch out a portion of the city's short-term debt until the city could regain entrance into the money market; and MAC was also designed to help order the city's fiscal affairs. Unfortunately, MAC by itself, armed only with powers of persuasion as to city finance, could not restore investor confidence.

The control board, and the powers given to it, are unprecedented in the history of State-city fiscal relations in this country. Hopefully, this program, when it is fully operative on October 20, will prove to be the effective tool needed to restore investor confidence in New York.

But, if these sweeping efforts fail, New York City and perhaps some of the agencies of the State government, face the clear prospect of default.

Today, the municipal market is a state of disarray. As a result, the market increasingly is failing to meet the legitimate needs of not only New York State and its local governments, but of State and local governments from one end of the country to the other. Tax-free interest rates are at awesome levels. For example, the Bond Buyer Index is at a record level of 7.67 percent, up 113 basis points from January of this year and up 249 basis points from January 1974.

Default by New York City will further worsen the difficulties State and local governments are presently experiencing in their attempts to raise capital funds. In my judgment, neither the market or an individual can accurately "discount" default by the Nation's largest city and center of its financial activities. Such waters are uncharted. Ripples can become waves, waves can become heavy storms, heavy storms can become hurricanes.

I won't cite the examples in my testimony regarding the high rates of interest and great expense to taxpayers elsewhere in the country. What is happening in Washington, Florida, North Carolina, and the city of Buffalo is being repeated on a daily basis.

The market is beginning to eliminate more and more bond issues resulting in job losses in the construction industry and in other areas of the economy. The postponement of worthwhile projects needed to meet the people's needs will be experienced increasingly in all sections of the Nation.

To the question as to whether the Federal Government should intervene, I believe that the Federal Government must intervene in this crisis if it is not to grow into a disaster situation. It is, in my view, in the best interest of not only the Federal Government, but of the communities of this Nation, for the Government to provide necessary mechanisms to prevent the economic and social dislocations that would stem from default by New York City.

I am not suggesting, nor have I heard a New York City or State official suggest, a Federal "bail out" program wherein New York City, or any other city or State instrumentality that may in the months ahead be closed off from the money market, be given a free ride. Any program involving Federal intervention or assistance properly should be accompanied by Federal requirements mandating that the city put its house in order, and rapidly.

As to the exceedingly complex question as to how the Federal Government should act to help in the New York City crisis, I would suggest a three-step program.

First, the Federal Government should step in quickly and provide a one-time guarantee of city or MAC bonds in the amount of \$3 to \$4 billion. This need not be a high-risk undertaking at all. Working through and with the State and its emergency financial control board, the Federal Government could help in stabilizing the New York City fiscal picture while the city moves toward clearly living within its means and systematically reducing its budget deficit.

Second, during the weeks ahead, the Congress and the administration, working together, should consider the development of a longer term solution to the problem of raising capital for needed State and local government activities nationally.

There is, in my judgment, merit in a Federal municipal bond insurance program available to State and local governments and their instrumentalities. Premiums for such insurance, the cost of which would be borne by the municipality, would be based on the risks involved. Again I would suggest that the Federal Government would have to monitor this program through some type of State control body.

Under such programs of Federal guarantee or insurance, the bonds issued probably should be subject to Federal taxation. On the other hand, those State and local governments with easier access to the money markets and having no need for these programs, could continue to issue tax-exempt securities.

Third, there is need to revise chapter IX of the Federal Bankruptcy Act to make it more workable in the event a municipality the size of the city of New York should ever default.

Again, thank you for the opportunity to comment on this issue which is of such importance to the future of our economic and social order and to our Federal system of government.

[The complete statement follows:]

Statement by Edward M. Kresky before the  
Committee on Banking, Housing and Urban Affairs  
of the United States Senate,  
Friday, October 10, 1975

My name is Edward M. Kresky and I am a vice president and director of public finance activities for the investment banking firm of Wertheim & Co., Inc. Prior to joining Wertheim in 1971, I spent more than 20 years in New York State and local government. I am a representative member of the Board of the Municipal Assistance Corporation for the City of New York.

At the outset, may I express my appreciation for the opportunity to appear before this distinguished committee.

The fiscal crisis facing New York City has been building up for a number of years. The roots of the problem are widespread and need not be rehashed again today. That the City of New York has lived beyond its means is self-evident. That the City, after recognizing the fact that it was drowning in its short term debt problems last year still failed to act vigorously enough to curtail expenditures was most unfortunate. This, of course, contributed to the credibility gap regarding the City's abilities of self-discipline which, in turn, manifested itself in the closing of the money markets for New York City.

In June of this year the State of New York attempted to aid the City through the establishment of the Municipal Assistance Corporation, empowered to stretch out a portion of the City's short term debt until the City could regain entrance into the money market; and MAC was also designed to help order the City's fiscal affairs. Unfortunately, MAC by itself, armed only with powers of persuasion as to City finance, could not restore investor confidence.

In September, the State, in Special Session of the Legislature, acted decisively by providing financial assistance to the City and by establishing an Emergency Financial Control Board, headed by the Governor, with broad powers to police and generally supervise New York City's finances.

The Control Board, and the powers given to it, are almost unprecedented in the history of state-city fiscal relations in this country. Hopefully, this program, when it is fully operative on October 20, will prove to be the effective tool needed to restore investor confidence in New York.

But, if these sweeping efforts fail, New York City and perhaps some of the agencies of the State government, face the clear prospect of default. Default by a City the size of New York, the financial capital of the nation, must have national and international implications.

Today, the municipal market is in a state of disarray. As a result, the market increasingly is failing to meet the legitimate needs of not only New York State and its local governments, but of state and local governments from one end of the country to the other. Tax free interest rates are at awesome levels. For example, the Bond Buyer Index is at a record level of 7.67 per cent, up 113 basis points from January of this year and up 249 basis points from January 1974.

Default by New York City will further worsen the difficulties state and local governments are presently experiencing in their attempts to raise capital funds. In my judgement, neither the market nor an individual can accurately "discount" default by the nation's largest city and center of its financial activities. Such waters are uncharted. Ripples can become waves, waves can become heavy storms, heavy storms can become hurricanes.

A few examples, all taken from the last month.

-- the State of Washington sold AAA public power supply bonds at a net interest cost of 7.72%. Just three months earlier this security sold at 7.04%.

-- the State of Florida sold full faith and credit AA bonds at 7.08%. One year earlier, they sold at 6.02%.

-- the State of Arizona's Salt River District sold electric revenue bonds at 8.17%. In April of this year they sold at 7.60%.

-- the North Carolina Housing Finance Agency on Tuesday, this week, suspended a \$50 million bond sale for 2500 housing units because they couldn't sell the bonds at rates that would have made the project feasible.

-- the City of Buffalo is experiencing the most severe difficulties in attempting to remain in the money market.

This is now being repeated on an almost daily basis. The market is beginning to eliminate more and more bond issues resulting in job losses in the construction industry and in other areas of the economy. The postponement of worthwhile projects needed to meet the people's needs will be experienced increasingly in all sections of the nation.

To the question as to whether the Federal government should intervene, I believe that the Federal government must intervene in this crisis if it is not to grow into a disaster situation. It is, in my view, in the best interest of not only the Federal government but of the communities of this nation, for the government to provide necessary mechanisms to prevent the economic and social dislocations that would stem from default by New York City.

I am not suggesting a Federal "bail out" program wherein New York City, or any other city or state instrumentality that may in the months ahead be

closed off from the money market, be given a free ride. Any program involving Federal intervention or assistance properly should be accompanied by Federal requirements mandating that the city put its house in order, and rapidly. The Federal government might consider requiring that the individual states set up control board type mechanisms to insure that its municipalities are meeting the Federal requirements.

As to the exceedingly complex question as to how the Federal government should act to help in the New York City crisis, I would suggest a three step program.

First, the Federal government should step in quickly and provide a one time guarantee of City or MAC bonds in the amount of \$3 to \$4 billion. This need not be a high risk undertaking at all. Working through and with the State and its Emergency Financial Control Board, the Federal government could help in stabilizing the New York City fiscal picture while the City moves toward clearly living within its means and systematically reducing its budget deficit.

Second, during the weeks ahead, the Congress and the Administration, working together, should consider the development of a longer term solution to the problem of raising capital for needed State and local government activities nationally. There is, in my judgement, merit in a Federal municipal bond insurance program available to state and local governments and their instrumentalities. Premiums for such insurance, the cost of which would be borne by the municipality, would be based on the risks involved. Again I would suggest that the Federal government would have to monitor this program through some type of state control body.

Under such programs of Federal guarantee or insurance, the bonds issued probably should be subject to Federal taxation. On the other hand, those state and local governments with easier access to the money markets and having no need for these programs, could continue to issue tax exempt securities.

Thirdly, there is need to revise Chapter IX of the Federal Bankruptcy Act to make it more workable in the event a municipality the size of the City of New York should ever default.

Again, thank you for the opportunity to comment on this issue which is of such importance to the future of our economic and social order and to our federal system of government.

The CHAIRMAN. Mr. Markowski.

Mr. MARKOWSKI. Because of a commitment which held me up, I have not written a statement. I agree with Mr. Harries I would prefer a direct loan to the State of New York rather than guarantee of the municipal bonds of the city or "Big MAC" bonds. I will provide a further written statement.

[Mr. Markowski's statement follows:]

## BANKING AND THE ECONOMY

Submitted to Senate Committee on Banking,  
Housing and Urban Affairs

October 10, 1975

"Federal Underwriting of Municipal Risks:  
Who Bears What Costs?"

Paul Markowski,  
Chief Economist  
Argus Research Corporation

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Many of the more dramatic claims about the impact of New York City's troubles on the municipal bond market have not bothered to complicate the issue with any reference to the facts. In particular, there has been a somewhat understandable inclination to attribute any and all increases in the yields of municipal securities entirely to the possibility of a New York default, rather than to fiscal troubles in other municipalities, or to a general rise in many interest rates having nothing to do with New York's situation.

From the last week of July to the week ending October 3rd, yields on Moody's new Aaa municipals rose 56 basis points and the Bond Buyer's index of 20 municipals rose 50 basis points. In the same period, however, yields on new Aaa utility bonds also rose 36 basis points, and 20-year U.S. Government bonds rose 32 basis points. So, a good portion of the recent well-publicized increase in the yields on municipals simply reflected a fairly general upward movement of interest rates arising from heavy Treasury borrowing, inflation expectations, and the Federal Reserve's

efforts to reverse the excessively rapid growth in the money supply during the second quarter. Thus, it is incorrect to attribute the broad rise in many interest rates solely to the turbulence in the market for municipal securities. If investors shy away from municipals, that would tend to increase the demand for alternative securities, raising their price and lowering their yields.

It is true, of course, that the yield spread between municipals and some other securities, particularly Aaa-rated corporate bonds, has been closing for many months. This shift in relative yields reflects greater awareness of the hidden risk involved in some municipal financing -- risk which exists quite apart from the outcome of New York's difficulties. There may also be some investor skepticism regarding ratings of municipal securities (Moody's only recently lowered New York City's rating below "A"), which would tend to add a premium to yields to compensate for the uncertainty, and would make comparisons with non-municipal securities more difficult. In any case, the effect of growing disclosure of fiscal problems in many municipalities (not just New York) is sometimes exaggerated by comparing the yields on top-rated corporate securities with the yields on some index of municipal securities which is composed of various (and sometimes declining) ratings of quality and risk. Care must be exercised not to compare oranges and onions, or at least not to be surprised that the oranges smell much better.

It cannot be plausibly argued that all municipal yields have already risen substantially in anticipation of a single possible default while simultaneously arguing that those yields will rise substantially more if the widely anticipated default becomes a reality. Either the effect has been largely anticipated, and the appropriate adjustments

made, or it has not. Capital markets are not easily surprised, so the effect has probably already been largely discounted in the form of higher municipal yields. And since uncertainty adversely affects any capital market, almost any resolution of New York's problems -- including default, but excluding repudiation -- could help to stabilize the municipal market.

Some of the hysterical rhetoric being used to describe the impact of default has been needlessly inflammatory, and perhaps more damaging than default itself. It is literally inconceivable that delayed payment on some city notes could cause an "international catastrophe," "worldwide depression," or collapse of "the entire credit system." Nor is there any reason to suppose that a default would mean that the city would stop paying municipal salaries, thus provoking a "revolt" by city workers (although the city workers appear likely to revolt over any plan to limit expenditures). One of the main reasons for a default would be to avoid paying interest to note-holders, precisely in order to continue paying routine expenses. There is no reason to default on both notes and salaries. Finally, it is simply not true that New York's problems have made it "impossible" for financially sound cities and states to borrow "at any price," although it is true that bad risks neither can nor should get infinite credit. In fact, state and local governments sold a third more long-term bonds in the first nine months of this year than they did a year before.

If the Federal Government comes to the aid of New York City, there will surely be strings attached. This implies another giant step away from our traditional system in which the residents of each community exert significant control over their own community affairs. That is a cost which must be weighed against any perceived benefits. And what

sort of message would the officials of other communities receive from any conceivable plan to rescue the city? Surely the message is to take more fiscal risks -- to please the local electorate by spending more and taxing less, always looking at the short run and ignoring the future -- secure in the knowledge that the burden could safely be shifted to the federal taxpayer.

Where would the federal government get the money to aid bankrupt cities? Most federal tax revenue comes from the already heavily taxed residents of cities, and there are distinct limits to the opportunity to shift the burden of urban spending to rural taxpayers. Getting the money from increased federal borrowing just means more trouble for prospective borrowers among consumers, business and municipalities, who are already having a rough time competing with a flood of Treasury securities. There is always the temptation to say that if there isn't enough money to go around, then the Federal Reserve should print more. But more money cannot create more real resources, and rapid growth of the money supply must ultimately dilute the purchasing power of each dollar, leaving nobody richer in real terms.

There is considerable interest in schemes to guarantee municipal securities, on the dubious grounds that this would be something less than a "bail-out." In fact, such a precedent would be even more ominous for the municipal securities market than a direct federal loan or grant. The practice of guaranteeing the worst of municipal securities would render the ratings of those securities absolutely meaningless. Thereafter, the riskiest of municipal securities, which would normally carry a higher yield to compensate for that risk, could be expected to become absolutely safe on a moment's notice.

Municipal authorities would have little incentive to maintain high ratings on their securities, since all municipal securities would be essentially risk-free for the investor. But the fiscal risk would not just disappear. Cities could still spend more than their revenue base could support, and they would in fact have even more incentive to do so. The constraint of declining ratings on city securities, with a consequent rise in borrowing costs, would have been removed. Any costs of default would simply be shifted from the investor in municipal securities to the federal taxpayer, and it is difficult to conceive of any method of forcing the cities to repay the money which would be consistent with any semblance of home rule. How, for example, would the federal government deal with a general strike among New York City workers? To ask such questions is to suggest the answer: the federal government should not get involved in the first place.

In the absence of federal intervention, a default by New York City is likely in December, if not sooner. The reverberations from such a default could make it impossible for New York State agencies to float additional debt, which, in turn, could make it extremely difficult for the State itself to tap the capital market. A chain reaction such as this could then force a default by New York State or by other cities within the state which depend on state aid. There could also conceivably be some "ripple effect" on distant municipalities, beyond those already discounted, although such "guilt by association" is not likely to seriously affect top-rated state and local borrowers.

Even under the worst possible scenario, short of assuming that investors would suddenly become totally irrational regarding their own wealth, there is no reason to suppose that a default by New York City or

State would halt recovery in the private economy. Indeed, any pinch on municipal borrowing would tend to increase the supply of lendable funds available to consumers and businessmen.

Nor is there much basis for assuming that a New York default would provoke an unmanageable "run" on Certificate of Deposit money in New York banks. These banks have protected themselves against such withdrawals by acquiring ample CD money in the past year or so, and the Fed, FDIC, and other regulatory bodies have ways of minimizing the impact of default. The most serious threat facing the New York banks is probably the threat of stockholder lawsuits prompted by the banks' purchases of New York City and MAC bonds. A problem for the municipalities themselves is the understandable hesitancy of bankers to add municipal bonds to their portfolios, whether as an asset or as a trading vehicle, particularly since the Comptroller of the Currency prohibits banks from purchasing municipals rated below Baa.

It is, of course, possible that urban interests, municipal bond dealers, and the affected banks may wield sufficient political clout to extract more federal aid for New York. The politics of the situation are not as obvious as they appear to the New York press, however, since rural antagonism toward profligate big cities is a very real force in the House of Representatives. If aid comes, it would be least damaging to the municipal securities market if it were in the form of a loan to the state - contingent upon appropriate fiscal reform, subordinated by state assets, and issued on terms sufficiently unattractive to discourage emulation. The municipal unions could, of course, wreck any plan for trimming expenditures, no matter how tidy the plan looks on paper, so a credible fiscal reform would have to come to grips with that problem.

The practical difficulty with a federal loan, however, is that it would be difficult to get the legislation through the required Congressional committees (Banking, Appropriations, Finance, Ways and Means, etc.) in time to beat a default. A federal guarantee of New York City or State securities could probably be expedited more quickly, and is therefore a more likely outcome. But as we have already observed such a precedent of turning a bad risk into a sure thing would play havoc with the ratings of municipal securities. The message to investors, as the Wall Street Journal put it, is that the greatest safety lies in the biggest bubbles. The result would be a wasteful allocation of scarce capital.

If New York City does in fact receive sufficient federal aid to get past its immediate crisis, the municipal securities market may just face a protracted interval of uncertainty and turmoil. For anything other than an unlimited blank check against the federal treasury will leave open the possibility that default has merely been postponed.

The CHAIRMAN. Thank you, sir.

Mr. Sellers.

Mr. SELLERS. I'm speaking today on behalf of the public finance council of the Securities Industry Association.

We think the consequences of a New York City default would be serious and far reaching. Their full scope is unpredictable, and the risks are large. The impact of the city situation has already spread to State agencies and the State itself, which have been denied market access despite admitted underlying credit-worthiness.

The council believes that the time has come for Federal assistance in the problem of market access, even though it has endorsed the policy of keeping pressure on city and State to effect the necessary long-range budgetary and management reforms.

That pressure should be maintained through the terms of a Federal assistance program. Such assistance should be available only on application of a State which has enacted a financial control program giving the State or a special State board or agency effective control over the financial operations of a municipality in difficulty with a view to the restoration of that municipality to financial viability.

The application to the Federal Government should show that:

(1) The State has exhausted all credit resources available, including the public markets and use of trust investments within the generally accepted rule of prudent investing.

(2) A clear case of financial emergency exists within the State.

(3) A plan for loan repayment has been submitted, with a complete analysis of the taxes or other revenues available and certification that the plan has been properly enacted and meets the requirements of the State constitution.

Federal assistance should be aimed at the problem of market access, and should not include any subsidy, either of the cost of borrowing or of repayment. The conditions that I have outlined above should be sufficiently onerous to discourage any use except in extraordinary financial emergencies.

A recitation of some foreseeable consequences of default is outlined in the next part of this statement, and a plan for Federal assistance that would avert default and its consequences is outlined in the last part.

If I may, I will run through a couple of the mechanisms.

We suggest that a Federal corporation should be established by Congress, the directors of which would be the Secretary of the Treasury, the Chairman of the Federal Reserve Board and three other members to be named by the President with the advice and consent of the Senate. It could be named the "Emergency Public Finance Corporation." The three appointed members would not be or become Government or corporation employees. The Corporation would be staffed to the extent necessary by existing employees of the Treasury and Federal Reserve Board.

The general purpose of the Corporation would be to provide, to or through a State, emergency financial assistance for local governmental units. Such assistance could be provided only under the following conditions:

(a) The State's legislature must declare that a period of financial emergency exists for the State by reason of the threatened financial collapse of a local governmental unit within the State.

(b) The Governor and the chief financial officer of the State must declare that the resources of the State are inadequate to prevent a default of the local governmental unit or of the State; that, to the extent permitted under the State's constitution, the State government has taken every feasible step to deal with the problem; and that there is in place a State apparatus for the control of the budgetary practices and expenditures of the affected State or local governmental unit.

(c) The Secretary of the Treasury or the Chairman of the Federal Reserve Board must declare that a default by such State or local governmental unit would have economic and financial consequences of more than local or regional significance.

(d) A majority of the directors of the Corporation must agree with the foregoing declarations.

The Corporation would have an authorized line of credit of \$10 billion with a limitation that no more than 50 percent thereof could be loaned to or through any one State at any time.

We are again joining in the estimate that \$5 billion would be adequate assistance.

The Corporation's obligations are to be purchased by the Federal Financing Bank, with no corporation obligations to be marketed to the general public.

The Corporation would be authorized to make loans only to the State itself or to a State agency specifically authorized by the State legislature to make such borrowings. The Corporation would be prohibited from making any direct loans to the affected local governmental unit other than the State agency mentioned above.

Local governmental units would be defined to include State agencies and local agencies as well as municipalities and other political subdivisions.

We avoid the guarantee for practical reasons. We think the market does not fully reflect a guarantee. A direct Treasury obligation will sell considerably better than a guaranteed obligation.

The limitations on loans by the corporation would include:

The interest rate must be 1 percentage point higher than the current rate obtained by the Federal Financing Bank on other obligations of comparable maturity it is purchasing.

The term of any loan made would be the period that the corporation determines is the least necessary in the circumstances with a maximum of 5 years, but renewable by the corporation for up to an additional 3 years.

Any drawdowns of an authorized loan may be used only to pay maturing debt obligations—both bonds and notes—of the affected State or local governmental unit that were issued prior to the authorization of the loan.

The State, or its specifically designated agency, must submit to the corporation at the time of applying for a Federal loan a plan for its repayment, and if the loan is not paid at maturity, the corporation may require the State to pledge its, or the affected local governmental unit's, share of general revenue sharing. In the New York State, this would represent \$400 million. We do not suggest that Buffalo or Syracuse revenue sharing should be pledged, only that of New York City and the State.

In the event that the Federal Government during the term of any loan assumes functions theretofore performed by the affected governmental unit—for example, a reorganization of the Federal welfare system—the amount of any fiscal burden from which the local governmental unit is thereby relieved must be applied by reduction of the Federal loan.

Any State to or through which such loans are made, and any local governmental unit receiving assistance, must adopt within 1 year thereafter Municipal Finance Officers Association—or even more stringent—accounting standards and publish at least annually financial statements in conformity with such standards, together with a full disclosure document.

[The complete statement follows:]

Public Finance Council  
Securities Industry Association  
October 9, 1975

Summary Statement

The Public Finance Council of the Securities Industry Association believes that the consequences of a New York City default would be serious and far-reaching. Their full scope is unpredictable, and the risks are large. The impact of the City situation has already spread to State Agencies and the State itself, which have been denied market access despite admitted underlying credit worthiness. The Council believes that the time has come for Federal assistance in the problem of market access, even though it has endorsed the policy of keeping pressure on City and State to effect the necessary long-range budgetary and management reforms.

That pressure should be maintained through the terms of a Federal assistance program. Such assistance should be available only on application of a State which has enacted a financial control program giving the State or a special State board or Agency effective control over the financial operations of a municipality in difficulty with a view to the restoration of that municipality to financial viability. The application to the Federal Government should show that (1) the State has exhausted all credit resources available, including the public markets and use of trust

investments within the generally accepted rule of prudent investing; (2) a clear case of financial emergency exists within the State; (3) a plan for loan repayment has been submitted, with a complete analysis of the taxes or other revenues available and certification that the plan has been properly enacted and meets the requirements of the State constitution.

Federal assistance should be aimed at the problem of market access, and should not include any subsidy, either of the cost of borrowing or of repayment. The conditions as outlined above should be sufficiently onerous to discourage any use except in extraordinary financial emergencies.

A recitation of some foreseeable consequences of default is outlined in the next part of this statement, and a plan for Federal assistance that would avert default and its consequences is outlined in the last part.

Consequences of Default by New York City

A default by New York City would be a financial event of the first magnitude, surpassing anything of like character since the banking holiday of 1933. Such an event would have many consequences, not all of which are foreseeable. Among those which can be speculated upon are the following:

1. One or more New York State Agencies might be forced to default through an inability to roll over maturing notes or to pay them off with the proceeds of new bond issues. Indeed, there is even now grave danger of default by an Agency. Should an Agency default, projects under construction and development could not be completed, with consequent layoffs, lawsuits by suppliers, and all the attendant problems that became so familiar during the UDC crisis.
2. The credit of New York State would come under very heavy pressure, as indeed has already occurred. The State could roll over maturing obligations only at extremely high rates; and it is quite possible, as the events of recent days indicate, that psychology might deteriorate so drastically that the State might have difficulty selling debt at any price.
3. Medium and lower quality municipal credits, which are even now being forced to pay higher rates than otherwise because of the New York situation, would suffer an impairment in their ability to raise funds at economic rate levels, probably for years on great numbers of people throughout the country with real and legitimate needs for public facilities and services.

4. The economic recovery now under way could be endangered by default, a point explicitly recognized by Dr. Burns. To cite only one of several avenues through which such impairment could occur, it may be noted that state and local outlays are projected by many economic analysts to rise by about \$20 billion this year-- about 25 per cent of the approximately \$80 billion increase in total GNP foreseen by many forecasters. State and local outlays are thus being relied upon heavily as a positive force in economic recovery. A default and its consequences would obviously have an adverse impact on such outlays.
5. Many small investors across the country would suffer losses on their supposedly safe investments, with consequent impact on retirement income.
6. New York City's position as the world's financial center might be seriously impaired. The tax burden would surely rise, and municipal services would be cut beyond anything now contemplated. Such a state of affairs would hardly be appealing to foreign entities which are already here or which are contemplating entry here.  
  
Default and its consequences would in all likelihood accelerate the exodus of productive businesses and individuals from the city. Hence default would not be rejuvenating; it would be debilitating. And its effects would be long lasting.
8. The immediate market reaction to default most clearly would be substantial price declines in both fixed income securities and equities, with only the Treasury bill market spared as investors sought a safe haven. If default on City obligations were shortly followed by default in the debt

of one or more State agencies, the disorder in the markets could continue for some time. Prospective borrowers would not wish to pay the high rates that would obtain in such circumstances. And prospective lenders would wish to place their funds in very short-term instruments of the highest quality. Thus the functioning of the capital markets could easily be impaired.

There would undoubtedly be other consequences of default that are not readily foreseeable. Those enumerated above are of such significance, and would involve risks of such magnitude, that we believe the federal Government should promptly enact machinery by which default could be avoided and which would not involve the establishment of unwanted precedents.

A proposal for such machinery follows.

Proposal for a Federal Loan Program to States for  
Benefit of Distressed Local Governmental Units

1. A Federal corporation should be established by Congress, the directors of which would be the Secretary of the Treasury, the Chairman of the Federal Reserve Board and three other members to be named by the President with the advice and consent of the Senate. It could be named the "Emergency Public Finance Corporation". The three appointed members would not be or become Government or Corporation employees. The Corporation would be staffed to the extent necessary by existing employees of the Treasury and Federal Reserve Board.

2. The general purpose of the Corporation would be to provide, to or through a State, emergency financial assistance for local governmental units. Such assistance could be provided only under the following conditions:

(a) The State's legislature must declare that a period of financial emergency exists for the State by reason of the threatened financial collapse of a local governmental unit within the State.

(b) The Governor and the chief financial officer of the State must declare that the resources of the State are inadequate to prevent a default of the local governmental unit or of the State; that, to

the extent permitted under the State's constitution, the State government has taken every feasible step to deal with the problem; and that there is in place a State apparatus for the control of the budgetary practices and expenditures of the affected State or local governmental unit.

(c) The Secretary of the Treasury or the Chairman of the Federal Reserve Board must declare that a default by such State or local governmental unit would have economic and financial consequences of more than local or regional significance.

(d) A majority of the directors of the Corporation must agree with the foregoing declarations.

3. The Corporation would have an authorized line of credit of \$10 billion with a limitation that no more than 50% thereof could be loaned to or through any one State at any time. The Corporation's obligations are to be purchased by the Federal Financing Bank, with no Corporation obligations to be marketed to the general public.

4. The Corporation would be authorized to make loans only to the State itself or to a State agency specifically authorized by the State legislature to make such borrowings. The Corporation would be prohibited from making any direct loans to the affected local governmental unit other than the State agency mentioned above.

5. Local governmental units would be defined to include State agencies and local agencies as well as municipalities and other political subdivisions.

6. Limitations on loans by the Corporation would include:

(a) The interest rate must be one percentage point higher than the current rate obtained by the Federal Financing Bank on other obligations of comparable maturity it is purchasing.

(b) The term of any loan made would be the period that the Corporation determines is the least necessary in the circumstances with a maximum of five years, but renewable by the Corporation for up to an additional three years.

(c) Any drawdowns of an authorized loan may be used only to pay maturing debt obligations (both bonds and notes) of the affected State or local governmental unit that were issued prior to the authorization of the loan.

(d) The State, or its specifically designated agency, must submit to the Corporation at the time of applying for a Federal loan a plan for its repayment, and if the loan is not paid at maturity, the Corporation may require the State to pledge its, or the affected local governmental unit's, share of general revenue sharing.

(e) In the event that the Federal government during the term of any loan assumes functions theretofore performed by the affected governmental unit (e.g., a reorganization of the Federal welfare system), the amount of any fiscal burden from which the local governmental unit is thereby relieved must be applied by reduction of the Federal loan.

(f) Any State to or through which such loans are made, and any local governmental unit receiving assistance, must adopt within one year thereafter Municipal Finance Officers Association (or even more stringent) accounting standards and publish at least annually financial statements in conformity with such standards, together with a full disclosure document.

The CHAIRMAN. Thank you very much.

Mr. Solari.

Mr. SOLARI. Mr. Chairman, I will be brief and to the point.

I am very reluctant to endorse any of the proposed legislative bills. In summary, I believe the cost disadvantages—as outlined, Mr. Chairman, in your opening statement—appear to outweigh the advantages. In particular, I cannot in any way visualize a set of controls which would be stringent enough to limit the application of Federal assistance to New York City alone. Rather, I believe such a program, if instituted, would represent a wide open invitation for public officials to make irresponsible fiscal decisions. It is my belief that a Federal aid program would impair the bargaining position of city administrators throughout the country in their budgetary process, for example, labor negotiations.

I am also very disturbed that the aid program will produce a dramatic transformation in the criteria employed by investors in their bond selection process. It is very possible that they will gravitate to securities issued by municipal entities which demonstrate the weakest credit characteristics—with a view toward the likelihood that the Federal Government will be the ultimate obligor of these bonds. This shift in investor attitude, of course, will directly penalize the most credit-worthy borrowers.

In respect to the consequences of default, I do not share the viewpoint that a New York City default would have a devastating impact on the municipal bond market. My opinion, however, is contingent upon the two following conditions which must accompany a default proceeding:

First, a contingency plan would be necessary to insure that the city's cash flow requirements would be satisfied in order that the city could continue to deliver essential services.

The second condition to an orderly default proceeding would be a well conceived reorganization plan which would encompass the enactment of adequate fiscal measures in actual dollars and a rearrangement of the city's debt structure. The latter would include an extension of the city's debt and the creation of an acceptable borrowing vehicle as part of a much needed long-term solution to attempt to restore investor confidence.

It is possible—but by no means assured—that a city default under these conditions would—within a short period of time—produce a positive reaction in the municipal bond market.

There are significant differences of opinion as to what will happen. Contrary to the opinion of other members of this panel, I believe the possibility exists that investor sentiment in the municipal bond market would improve if New York City's problems were resolved by a debt reorganization plan. My observation does not in any way minimize the seriousness of default. Also, I am not suggesting that a debt reorganization plan be pursued as an acceptable alternative to default. However, if one assumes that such a plan was implemented, it could prove beneficial by removing the uncertainty of whether the city will be able to meet its next debt payment. Consequently, the credit of New York State would be divorced from the city, a circumstance which will—in my opinion—enhance the ability of the State to retain access to the market. It is also conceivable that the market value of city securi-

ties would improve if the plan documented the capacity of the city to service its debt over the long term under a revised maturity schedule. The depressed price levels of city securities today reflect the fact that the investor is unable to predict this possibility at this time.

[The complete statement follows:]

STATEMENT OF WILLIAM J. SOLARI, VICE PRESIDENT, DONALDSON, LUFKIN & JENRETTE SECURITIES CORP.

I am William J. Solari, Vice President of Donaldson, Lufkin & Jenrette Securities Corporation. Situated in New York City, the firm is involved in the various activities of the securities business and serves primarily an institutional clientele throughout the country. We are a major underwriter and distributor of fixed income securities through the operation of our corporate, government, and municipal bond departments. I am directly responsible for bond research, including the credit analysis of tax-exempt securities issued by states, their agencies, and local municipal subdivisions.

My comments do not necessarily reflect the viewpoint of my firm—DLJ. Clarification of this point is required because the Chairman of DLJ Securities Corporation, Mr. George D. Gould, is a Director of the Municipal Assistance Corporation for the City of New York, and Chairman of its Finance Committee.

I am very reluctant to endorse any of the various legislative proposals to guarantee or insure municipal securities. In summary, I believe the cost disadvantages (as outlined in Chairman Proxmire's opening statement) outweigh the advantages. In particular, I cannot in any way visualize a set of controls which would be stringent enough to limit the application of federal assistance to a few financially hard-pressed municipalities. If an aid program is instituted it would likely represent a wide open invitation for public officials to execute irresponsible fiscal decisions to qualify. It is my belief that a federal aid program would impair the bargaining position of city administrators in their budgetary process, i.e., labor negotiation, etc.

Also, I am very disturbed that the aid program will produce a dramatic transformation in the criteria employed by investors in their bond selection process. It is very possible that they will gravitate to securities issued by municipal entities which demonstrate the weakest credit characteristics—with a view toward the likelihood that the Federal Government will be the ultimate obligor of these bonds. This shift in investor attitude, of course, will directly penalize the most credit worthy borrowers.

In respect to the consequences of default, I do not share the viewpoint that a New York City default would have a devastating impact on the municipal bond market. My opinion, however, is contingent upon the two following conditions which must accompany a default proceeding:

1. A contingency plan to insure that the city's cash flow requirements would be satisfied in order that New York City could continue to deliver essential services. Needless to say, civic chaos would evolve if a default impaired the City's ability to meet expenditures for payroll, welfare, etc. While I do not have direct access to reliable information as to the actual dollar imbalance of city monthly receipts vs. expenditures for operations during the period ending June 30, 1976, rough estimates suggest that the deficit figure is less than \$1 billion. It is probable that sufficient resources are available and could be employed to meet this cash operating deficit—as compared to the less manageable figure of approximately \$4 billion to prevent default during the next eight months.

2. A well conceived re-organization plan which would encompass the (a) enactment of adequate fiscal measures in actual dollars, and (b) a rearrangement of the City's debt structure. The latter would include an extension of the City's debt and the creation of an acceptable borrowing vehicle as part of a much needed long term solution to attempt to restore investor confidence.

It is possible—but by no means assured—that a City default under these two conditions would—within a short period of time—produce a positive reaction in the municipal bond market. The marketplace has been anticipating a New York City default for many months. A resolution of the problem would provide long awaited relief by removing the uncertainty which has lingered since the market was closed to the City earlier this year. New York State, for example, has been denied market access because investors have recognized that the State's credit is directly intermingled with the City's. If the New York City

problem is resolved, it is likely that the market for State general obligation securities would re-open.

In closing, I would like to emphasize that my observations do not in any way minimize the seriousness of default and that a debt re-organization plan should not be pursued as an acceptable alternative to the continued efforts to avoid default at the state and local level. Also, it is my strong conviction that one of the major reasons that the Committee is facing this serious dilemma today is the failure of New York City to provide sufficient credit information to investors.

Whatever course the Committee and Congress decide to follow, it is imperative that serious consideration be given to mandating state and local government officials to provide adequate credit information. Hopefully, the requirement to provide a constant flow of data will signal credit problems early enough so that adequate steps may be taken to insure municipal issuers continual access to the market.

The CHAIRMAN. Thank you, gentlemen.

Mr. HARRIES, you indicated you think the default of New York State is unlikely, but you indicated that some of the agencies might default.

Mr. HARRIES. That's correct.

The CHAIRMAN. I realize we have a gamut of opinion here. In the event New York agencies did default, do you still feel that the State would be able to raise money in the capital market despite the fact that New York City defaulted and some of the agencies defaulted?

Mr. HARRIES. Mr. Chairman, it is important to understand that the State does not need money in the capital market to meet its own maturing debt. If the State stayed out of the capital market, it would be fine. It meets its maturing short term debt out of general revenue. The State each year in the spring borrows between \$3 billion and \$4 billion in notes, payable for revenues that come in all year long. It currently has outstanding \$2.5 billion notes, which it will meet with the tax revenues that come in through the end of March.

The call on the State that has come from New York City—and we told the State 3 weeks ago that this was all they could do because the State will end its fiscal year with a deficit of a half billion dollars which must be funded—has complicated the State's problem. It is required they fund their deficit. If they don't fund it, they may be violating the law, but they have no debt to meet, and there is no default. The State bonds, we rate double A, and continue to think of them as a fine credit. The State doesn't have to borrow to meet maturing bonds. It redeems its maturing bonds out of income.

The CHAIRMAN. You made your point clear. That is helpful. The State itself, the agencies of the State, however—

Mr. HARRIES. New York State Housing Finance Agency bonds are well secured by facilities that are operating filled with people who pay rents and so on. Their problem of default, again, is with the maturing short-term debt. The New York Housing Finance Agency has \$1.1 billion of notes coming due in the next year. It is this that could trigger a default; that is, if they are stopped from going to the market, and they are shut out of the market now.

The CHAIRMAN. If New York City defaults, then some of the agencies could default on their notes?

Mr. HARRIES. They will default on their notes; yes, sir.

The CHAIRMAN. What effect do you think that would be likely to have on interest rates for municipal bonds generally around the country?

Mr. HARRIES. I think it will be bad, but it is blown a little out of proportion.

The CHAIRMAN. It may increase the yield by half a percent or 1 percent?

Mr. HARRIES. On the better credits, it may go up half a percent. On the lesser rated credits, higher.

The CHAIRMAN. In view of the fact there is about \$200 billion of obligation being funded, the cost would be \$1 billion or \$2 billion.

Mr. HARRIES. No, the annual rate of net new debt issuance each year is \$20 billion. Your figure would apply to that.

The CHAIRMAN. \$1 or \$2 billion over a period of years, period of 10 years in view of the fact that the bond life might average 10 years. The cost would be \$10 billion if this should last a year. That may be disseminated all over the country as well as New York.

Mr. HARRIES. Yes, sir. I do think a default at the agency level in New York will close the market to many entities in New York. If New York State cannot sell its notes, the mammoth amount of notes they normally do in the spring, they will be unable to give the cash to some 220 school districts to finance their schools. Many of the schools have borrowed from the local banks contingent on the money coming in in April. If that money doesn't come in April, they will default.

The CHAIRMAN. Mr. Kresky, you indicated that the amount of the guarantee should be around \$3 to \$4 billion. The Governor, as I understand, has told us they wanted about \$5 billion. Their capital requirement over the next 6 months I understand will be added up to \$5.1 billion.

As I recall, they turn over \$2.8. Their deficit is \$800 million; \$1.7, then, for capital requirement.

How do you shave that to 3 or 4?

Mr. KRESKY. The recommendation I gave, Mr. Chairman, dealt only with the short-term, uncovered New York City debt from that December date until the end of the city's fiscal year of June 30.

I understood the Governor's reasoning. I don't disagree with the reasoning. I do think if the Federal Government were to give a guarantee to MAC of \$3 billion which is about the existing statutory capacity of MAC's borrowing capacity—it could be altered if revenue flows were set up accordingly—I would think that a \$3 to \$4 billion guarantee, which is what my testimony called for, would probably do the job of beginning the restoration process.

As you quite clearly indicated, the five of us have very different views. My view regarding the ability of the State of New York in April to raise the necessary billions of dollars Mr. Harries referred to which in turn impacts upon the school districts and local governments throughout the State, is that it is a serious problem.

If the city is in default in December, as Mr. Rohatyn says, is a strong possibility, if the agencies of the State are in default which the Governor indicated is a strong possibility, and if the pension funds are shut out or available only in a limited manner, I have some serious doubts in my own mind that the State of New York can raise those necessary billions in April and that the end result would find school districts and local governments throughout the State in deep peril, and a community of 18 to 19 million people in this country shut off from money markets and not available to get capital funds.

The CHAIRMAN. Mr. Solari, you regard that as most unlikely. You told us you do not think the Federal Government should act in this case.

Mr. SOLARI. I am reluctant at this time to endorse any of the proposals. Mr. Chairman.

If the disaster scenario which Mr. Kresky refers to were to become a reality, and then units of government could not provide essential services throughout the State, obviously, one would have to reconsider the position of Federal assistance.

At this time, I don't believe it is necessary.

The CHAIRMAN. We have to act very rapidly, of course, to do any good as far as New York City is concerned. Congress doesn't act the way an individual acts—we have to take it to the committee and to the floor and get it to the President to be signed. We don't have the luxury of being able to wait.

Under these circumstances, do you advise the committee not to proceed in view of the timing here? We are told that December 1 is probably the last day on which in all likelihood New York could avoid default. If there is no real progress by then, they are in very, very serious jeopardy.

Don't you agree with that?

Mr. SOLARI. I do agree with it. The city is in very serious jeopardy of defaulting at any time.

The CHAIRMAN. I beg your pardon. I understood you to say if they did default, however, you feel the repercussions would not be as serious as others have said.

All right. Accepting that, you say they will not be as serious as far as New York State is concerned.

Mr. SOLARI. They may not be. With respect to the default implications on the market, there is a possibility that it would be treated as relief by investors, that the State's credit would no longer be impaired by further efforts to rescue the city from default. As such, the State may restore its credit dignity in the market because it would be divorced from the city.

The CHAIRMAN. Does it seem logical that having had New York City unable to pay its obligations that banks and other investors would say, "We will not invest in New York agency obligation." If you were the head of a bank, would you advise that they invest in that?

Mr. SOLARI. I would think the process here would be subject to analysis. If the State, as Mr. Harries indicated, had notes and they had the capacity to retire those notes with adequate receivables, and you could demonstrate the credit of the State of New York was adequate, perhaps the State and its agencies could survive in the market.

The CHAIRMAN. Perhaps the State could survive.

You are with a fine brokerage firm. Would you advise your clients to go into a municipal bond in the wake of New York City default? What do you think would be the reaction of a customer if you tell them that New York City has defaulted, and you say this is something you should invest in.

Mr. SOLARI. If you could demonstrate to the investor that the issue you are referring to has the capacity to repay the debt obligation, there is reason to sell the securities to him.

The CHAIRMAN. Don't you think in many cases investors are cautious after a catastrophic event of that kind? They have read about it and watched it on television.

Don't you think they would say, "Let's stay out of New York"?

Mr. SOLARI. An alternative, Mr. Chairman, is that there is no reason to expect that the investor, just because the city went into default, would expect that the State doesn't have the capacity to pay its bonds.

The CHAIRMAN. I take it you would personally advise your customers to purchase State paper.

Mr. SOLARI. I'm not doing that now, sir, for the obvious reason that the Governor and his financial adviser have stated publicly that the State may default in the spring if the city defaulted. However, circumstances are likely to change and there may be an opportunity to have a rational analytical discussion with the client to purchase State securities at a later date.

The CHAIRMAN. Mr. Markowski, why a loan to the State instead of guarantee? A loan is legislatively harder. We have to get appropriations for the loan. We have to go through different committees.

If we set it up as you have suggested, we have to confirm the nominees of the President. Timing is important. We can't investigate the fire department, we have to send them to put the fire out.

Mr. MARKOWSKI. The guarantee of the bonds and notes of the State or city would only open up a Pandora's box to other municipalities.

The CHAIRMAN. Why won't a loan do the same thing?

Mr. MARKOWSKI. I don't think so. If there were strings attached to it, I think the loan would do a better job. It would mean for an orderly municipal bond market. We may well do away with rating systems.

The CHAIRMAN. The guarantee would require an issue that is taxable. It has to be an issue that comes in under circumstances where you require a premium to be paid. That would probably be required. It would have to have the full faith of the State to get it. You have to agree to have a financial plan with a balanced budget; all these things.

Mr. MARKOWSKI. Yes, under those circumstances I would, but I think it opens up a Pandora's box.

The CHAIRMAN. You mean you think the guarantee's difficulties would be minimized?

Mr. MARKOWSKI. Minimized, yes, but I am still not in favor of guarantees.

Mr. HARRIES. I would like to make a comment. My provision for the loan calls for the loan to be subordinated. Most States cannot assume general obligation debt without voter referendum. My suggestion is the Federal loan be subordinated to the general obligation bonds of the State.

The CHAIRMAN. When you say that, what you are saying is if we provide a loan, it should not go at the top of the payoff. It has to be subordinated while previous debt is paid off.

Mr. HARRIES. New York State cannot borrow \$5 billion from the Federal Government and call it a general obligation. Under the constitution of the State of New York, such obligation requires voter referendum approval.

Senator PACKWOOD. Mr. Solari, Mr. Harries talks about a bond—he says has three strikes against it today. As a matter of fact, that would be a good investment today.

Mr. SOLARI. I believe the bond you refer to is the Battery Park city authority.

Senator PACKWOOD. Right.

Mr. SOLARI. There is risk in that bond at the present time as to the ability of the authority to service the debt over a long term because the bonds were sold to finance the construction of a housing project which has yet to be completed. Actually, it hasn't even started. It is a site off of Lower Manhattan. Until they complete the construction of the housing units, and you have an opportunity to analyze the cash flow from those units to service the debt—

Senator PACKWOOD. What you are saying—let me interrupt you. You are saying this bond is depressed by more than just psychological reasons?

Mr. SOLARI. There is a credit problem.

Senator PACKWOOD. I got the impression from Mr. Harries' statement that there was nothing more to it than psychology.

Mr. SOLARI. Perhaps Mr. Harries was referring to the fact there is approximately \$150 million in a construction reserve account that may be used for project construction, but also may be used—but not required—to service the bond.

Senator PACKWOOD. This morning Governor Carey or Mr. Rohatyn testified that many of the major New York banks were buying New York municipal bonds in greater quantities than they should have. They also were to blame. The bonds were rated higher than they should have been. Some banks were in too heavily. Is that a fair statement?

Mr. HARRIES. It is important to recognize two things: One is the net worth position of the New York securities in the banks. The second thing was the fact that New York banks stood up and ate all of these securities that New York City came in with.

Senator PACKWOOD. What kind of rating were the city bonds carrying from Standard & Poor?

Mr. HARRIES. We had an A rating until 6 months ago.

Senator PACKWOOD. Were the banks pressured into buying them?

Mr. HARRIES. I can't speak for the banks. Increasingly, the amount of short-term money the city had to borrow was up. Yes, there was pressure to underwrite that.

Senator PACKWOOD. The banks could have been buying better rated municipals?

Mr. HARRIES. They were underwriting city issues where they were buying to resell to the national market. What they put in their trust accounts and portfolios, we don't know.

Senator PACKWOOD. Were they successful in reselling them?

Mr. HARRIES. No. That was the problem. The stream of bonds and notes became too great.

Senator PACKWOOD. They could have underwritten better municipal bonds around the country that would have been easier to sell, but for some reason, they felt a moral obligation to take New York bonds?

Mr. HARRIES. The New York market began to close when we saw other banks around the country dropping from the underwriting accounts, such as major California banks, Texas banks, and Chicago banks. They said, "We can't take any more because the portfolios are out of balance."

Senator PACKWOOD. The New York banks had to do this underwriting?

Mr. HARRIES. Yes, sir.

Senator WILLIAMS. Thank you very much.

I regret I wasn't here for all of the testimony of this distinguished panel. Mr. Harries, I wonder if you have spelled out why it is you feel that a Federal loan in this situation would be superior to the guarantee approach?

Mr. HARRIES. I approach the question that Senator Proxmire posed to me in his letter last week from two sides. Should the Federal Government become involved in New York City? and two, how?

In commenting on the other bills, I took what I thought would be the easiest, safest, neatest approach. And Senator Proxmire enlightened me a few moments ago by saying it is difficult to get a direct loan. I do think a loan is the easiest way to do it. It gets the best interest rate because Treasury securities sell at the finest rate in the country. No Federal agency sells at as good a rate.

I took the approach of a loan so there would be direct control. If that can't be done quickly, I am willing to back up to a guarantee. But guarantees sell at discounts. We saw in the public housing issues that were backed by a Federal guarantee that they sold at different interest rates. You would have 35 cities selling in one day and the spread could be one percentage point. The ultimate backing behind the bond was the Federal guarantee. That is why I believe the loan route is the most direct. I thought it was the easiest, but I guess it isn't.

Senator WILLIAMS. We have tried to persuade Administration officials' of the superiority of this approach for specific situations. It is neat and clean. I agree with you. If you can get it on the books in certain circumstances, it is the most efficient way to reach your objective. But is very hard to get congressional support for such an approach. We have had a difficult time with direct loans for example for housing for the elderly.

I agree with you, Mr. Chairman, this would be a difficult approach.

Now we have had—I gather you have been hit with many legislative ideas. There are several bills and we have had another approach just suggested by Senator Cranston's bill. As he described his idea, it made sense to me. At any rate, in your statement you talk about the great discount of some municipals in New York; for example, that the discount makes no sense in terms of the security which is behind it.

I am just wondering whether you have observed, and I am sure you have, whether the ripple effect which we all fear has gone beyond New York and New York City and New York State to other places. I have heard bits and pieces of opinion that it has already, to the detriment of other borrowers.

Mr. HARRIES. Battery Park project has a questionable backing. It has the moral obligation of the State, the same wording which the New York State Housing Finance Agency does, Dormitory Authority of New York State does, which in essence is a budget make up.

If I can bring us closer to home to New Jersey, Senator Williams, the New Jersey sports exposition has the same wording. Those bonds sold at par with a seven and one-half, coupon and they are currently selling in the 60s. If they had to sell bonds to finish the project next week, if they didn't have enough money to finish it, they would have to come to market with 13 or 14 percent to equal the yield on the bonds that are presently outstanding.

The CHAIRMAN. 13 or 14 percent interest?

Mr. HARRIES. Yes, tax free. That is what the bond is selling for now with the moral obligation of the State of New Jersey and we rate New Jersey triple A, Senator. That is a ripple across the Hudson, Senator.

Mr. KRESKY. I would like to comment on that, too, Senator Williams. I would like to further discuss the Battery Park city bond which has a credit problem. One of the problems is that there is a landfill and there has been nothing built. It has been that way for 4 years. Let's take the housing finance agency, which sold over \$5 billion worth of securities, almost \$4.25 billion worth of bonds and \$1 billion worth of notes presently outstanding. It is an agency with a great track record that built the State university system in New York and a number of other things, with a highly regarded management. Their bonds are selling in the thirties and forties. Current yield on the bonds are, as Mr. Harries indicates, 13 and 14 percent for one of the most highly regarded agency pieces of paper in the business.

The effect of this situation has been a very cruel one. It is getting to be increasingly cruel. I referred in my testimony to the North Carolina Housing Finance Agency. They were unable—they withdrew a \$50 million bond issue on Tuesday of this week because of interest rates that would have made the project unfeasible.

Now I say we are not talking about ripples any more. We are now at waves. I am deeply concerned that these waves grow taller in the weeks and months ahead. I agree with the position the Governor has taken and the position that MAC has taken regarding a guarantee because of the swiftness to put off what I think would be a very, very great fiscal disaster. On this I would have to disagree with my good friend Bill Solari. No one has discounted it because no one has experienced what we possibly may have to experience.

Senator WILLIAMS. Now I will try to condense this and I am not sure I have the skill to do it in the area of finance. As I understand it, default is—you arrive at a default when the issuer cannot meet its obligation and the first obligation is that periodic intrayear short-term interest payment being made.

Now it was explained earlier that in order to meet these intrayear expenses, you have to be able to go to the market and borrow short-term to pay recurring intrayear expenses; is that right?

Mr. HARRIES. Through issuing debt, yes, sir.

Senator WILLIAMS. Yes, we are talking about debt. Now, our earlier witnesses said that the New York entities, city and State, can't go to the market today.

Mr. HARRIES. That's correct.

Senator WILLIAMS. That puts me in Mr. Solari's position. I don't see where we are. Where is New York State going to get that money if it can't go to the market.

I know there are a lot of potential purchasers for a great New York State asset. The developers would love to get their hands on the Adirondack State Park. I know it is a matter of absolute fact. They are waiting to get their pieces of Adirondack Park to develop.

I don't know whether that is socially, economically or in any other way wise. What will they do without selling capital to pay debt expenses?

Mr. SOLARI. It is my understanding that the State does not need to raise money in the capital market to pay debt expenses.

Mr. Chairman, it is not my intention to turn this panel discussion into an open debate, but since I share the only viewpoint that the New York City problem has been discounted in the market, I believe it is appropriate to elaborate on this point. Testimony was given earlier today by Mr. Rohatyn who accurately identified that New York State and its agencies have encountered market rather than credit problems.

The unsuccessful effort to sell "MAC" securities to investors outside New York State was directly responsible—in my judgment—for this marketing problem. The unprecedented 11-percent coupon placed on the last public "MAC" issue reduced the value of other New York State "moral obligation" bonds in the market, including HFA securities. The reduction in market value of these securities was not the only problem created by "MAC." The failure of "MAC" to continue to finance itself in the public market stimulated concern by investors that other State agencies would be closed to the market. This scenario apparently set into motion the decision by investors to liquidate their New York holdings, regardless of credit standing. The market was closed to the State following the legislature's decision to sell its securities to assist the city. Therefore it is logical to reason that the various efforts at the agency and State level to assist the city has been the primary cause of the problem. For this reason, it has been discounted in the market. If the city problem was resolved by a reorganization, is it not probable that the State and agencies securities would have a better chance to get back into the market—since the burden of the city would be removed?

Mr. SELLERS. I disagree with you somewhat. If New York City goes to default, it will be many, many years before they can issue bonds again. What we think would happen is that the agencies' notes would go into default, State agencies' notes, various ones and some school districts would go into default, because of a lack of market access.

This would mean a substantial number of people that would be unable to construct any new schools or courthouses or firehouses or what have you. I would suggest it is unlikely that the U.S. Congress would not act if this developed.

The pedagogical benefits of New York City's mistakes have been gained. If Congress acts to redress this situation, it seems appropriate to do it now when it can be done easily. If the mechanism were put into place, it might never be needed.

Number one, it would not have to be used until it was necessary. To take the risk just seems unnecessary.

Senator WILLIAMS. I won't go on. Thank you very much.

The CHAIRMAN. Mr. Solari, you said a well-conceived plan of handling the rollover could be worked out and in that event default wouldn't be so bad. It could be handled rather smoothly and might not have an adverse effect.

Here's what concerns me as I look at the arithmetic. In the next 6 months, there will be a rollover of the \$2.8 billion in short-term obligation. In the next 6 months deficit in the operating budget of \$800 million. In the next 6 months there will be capital investment commitments due of \$1.5 billion. That is \$5.1 billion.

Where will the money come from? If you could tell the rollover

people too bad we can't pay you off, you will have to refinance on 10- or 20-year basis, that wouldn't solve the problem. You would have a \$2.3 billion problem that wouldn't go away. Where will you get the money for that?

Mr. SOLARI. Since it is not possible to validate the figures that you are referring to, I will refrain from answering this question. Between September and June, I understand the city's cash flow problem is in the area of \$1 billion for operating expenditures. If you would include a billion dollars for capital improvements then perhaps the plan would call for a reduction in the financing of those capital improvements—

The CHAIRMAN. They put that into effect. That is, take into account the fact they have put a freeze on all new capital construction. The 1.5 is for the capital needs already underway. You stop constructing schools, hospitals, et cetera, and stop that cold at a time when unemployment is one of the most serious economic problems.

Mr. Sellers thought under these circumstances, he thought likely the Federal Government would come in rather than see this kind of catastrophic development in one of the biggest States and the biggest city in the country.

Mr. SOLARI. I would think that the Federal Government would come in.

The CHAIRMAN. If the Federal Government steps in, then isn't that worse than coming in with a guarantee now that will avert all this misery when New York has already done so much? They have frozen their hirings. They have already refused to increase pay at all. They have agreed to a balanced budget over the next 3 years.

Even their management is under the discipline and control of a State appointed body that has the right to approve every expenditure and every borrowing.

Mr. SOLARI. My only answer to that is that it has not been enough to convince investors. One of the reasons for this, Mr. Chairman, it has not produced a reduction in hard dollars.

The CHAIRMAN. What can they do? Suppose you were mayor in this position, what would you do?

Mr. SOLARI. Until I had access to all of the information, I cannot answer that, sir.

The CHAIRMAN. Mr. Kresky has access to a great deal of this information as one of the members of MAC. His advice and he is an honest man I'm sure, as I understand it—you can tell us; Mr. Kresky—he thinks there are no resources there. Am I right or wrong?

Mr. KRESKY. I would have to say, Mr. Chairman, that the city performance has been accelerating. It was at zero 6 months ago. MAC helped it. The Control Board and MAC working together now has greatly accelerated it.

As the Governor indicated earlier today, the wage freeze, freeze on new hirings, and all these other factors—the fact of the matter is in an inflationary time, to cut back a budget is quite an accomplishment. Under the Emergency Control Board on the 15th of this month, we will get a plan and on the 20th, they put it into effect.

Importantly, from the 20th on, as Judge Rifkin indicated, every single piece of revenue for the city, Federal aid, State aid, tax money is in the hands of the Control Board. They will dole it out and I hope they dole it out very, very gingerly.

I think that the progress being made is now increasingly significant. I don't believe that it is possible in one fell swoop to lop off 60,000 or 70,000 employees, or as Mr. Rohatyn said, \$10,000 tuition charges and the other matters in order to restore immediately investor confidence.

We need a planning program. We need turnaround money which could best come from a Federal guarantee and it would be a very low-risk guarantee.

The CHAIRMAN. Finally, let me ask Mr. Sellers and the rest of you to comment, if you would like, if New York City falls and the New York clearinghouse banks face up to writing off their losses, can we be sure that large certificates of deposits holders, the big depositors won't withdraw their funds from New York banks and do so pretty promptly?

Mr. SELLERS. One of the problems with this type of thing is that it is—I think investors tend to be a nervous type. You don't know what might happen. That is obviously one of the risks.

The CHAIRMAN. We have been concentrating on the fact that the banks holds 10 to 20 percent of their capital in New York City obligations. But that is a relatively small amount in view of their total assets. It is less than 1 percent. It could trigger, nevertheless, a serious run on the part of big depositors. I don't say it will occur but it is a possibility.

Mr. SELLERS. I think that is right. It is a small amount in relation to total assets. There is not a rational danger, but you never know with a loss of confidence what may happen.

The CHAIRMAN. Any of the rest of you like to comment?

Mr. MARKOWSKI. I agree, Mr. Chairman, there would be some risk that there would be a run off on certificates of deposits. As an observer of the money market, I believe every since May or June of this year that the New York City banks have been so aggressive borrowers in the certificates of deposits market, in the intermediate 6 months, year market, to offset the potential runs that may occur.

Mr. HARRIES. The total capitalization of the 11 clearinghouse banks in New York is about \$8 billion. New York paper is about \$1 billion of that. Chairman Burns said he would permit a period of time for this to write that down. Even though a municipality goes into default, it is not a Lockheed. Lockheed was subject to dismemberment. New York will not fall into the earth.

The CHAIRMAN. Unfortunately, we saved Lockheed. I did my best to stop that.

Mr. HARRIES. Penn Central or Lockheed. I think the immediate run on certificates of deposit would be short. It would be primarily in the foreign market. Foreign governments think we are crazy to talk about this so much because they wouldn't even let it happen in England and France. The history of municipal defaults in France is zero. I think their preachings about international impact on banking are a little hysterical.

The CHAIRMAN. This is something else. Dr. McCracken who is a distinguished economist, Chairman of Economic Advisers a couple of years ago and conservative gentleman generally, he said the precarious plight of New York made it difficult to make forecasts about the trend of the national economy.

Mr. HARRIES. I look for a default of New York to be a national catastrophe for us. It would cause default in government agencies. When the city of New York goes into default, it would make massive efforts to make principal and interest payments on bonds, even to the point of skipping a payroll. If you skip a payroll, there will be calls for a general strike. There will be job actions and there could be unrest in the civil population. These are the things I fear.

To correct that requires Federal action far and above what we are talking about here today.

I would like to say, too, Mr. Chairman, the idea of having to see the Governor of New York and its elected officials come to the Federal Government to ask for aid is abhorrent to me. I look on what we are trying to do today as the lesser of two evils and one to be done away with as quickly as possible.

The CHAIRMAN. Thank you gentlemen very, very much. That was most helpful testimony.

We will reconvene at 2:30 to hear four distinguished witnesses in the Banking Committee hearing room.

[Whereupon, at 1:30 p.m., the hearing was recessed, to reconvene at 2:30 p.m., this same day.]

The CHAIRMAN. You gentlemen are very patient. I am grateful to you for coming this afternoon.

This morning it was a prolonged hearing. There was no way for us to let all of the Senators ask questions and get through with everyone until now.

Our next witnesses are Grady Fullerton of Harris County, Houston, Tex.; Joe Torrence, Metropolitan Government, Tennessee; John M. Urie, Kansas City, Mo.; and John Petersen.

**STATEMENTS OF S. GRADY FULLERTON, HARRIS COUNTY AUDITOR, HOUSTON, TEX.; JOE E. TORRENCE, DIRECTOR OF FINANCE, METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVISON COUNTY, TENN.; JOHN M. URIE, DIRECTOR OF FINANCE, KANSAS CITY, MO.; AND JOHN PETERSEN, MUNICIPAL FINANCE OFFICERS ASSOCIATION**

The CHAIRMAN. Any order you gentlemen would like to go ahead in is fine with me.

Mr. Urie will be No. 1.

Mr. URIE. Thank you, Senator Proxmire, and thank you for inviting us and allowing us this time. I have a summary statement that has been handed to you. I ask that it be made a part of the record.

The CHAIRMAN. That will be printed in full in the record.  
[Complete statement follows:]

SUMMARY OF STATEMENT

S. GRADY FULLERTON  
Harris County Auditor, Houston, Texas

JOE E. TORRENCE  
Director of Finance, Metropolitan Government, Nashville & Davidson County, Tenn.

JOHN M. URIE  
Director of Finance, Kansas City, Missouri

JOHN E. PETERSEN  
Washington Director, Municipal Finance Officers Association

On behalf of the

MUNICIPAL FINANCE OFFICERS ASSOCIATION

Before the

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS, U. S. SENATE

October 10, 1975

The Executive Board of the Municipal Finance Officers Association has adopted the attached resolution calling for immediate Federal action to establish Federal credit assistance for states and localities that, in the absence of an ability to borrow in the capital market, are faced with imminent default.

The resolution essentially calls for a Federal "lender of last resort". It is tailored to the immediate crisis at hand, one of an actual or impending insolvency that is caused by a lack of confidence, a lack of willingness or ability of investors to accept the uncertainties involved in lending to certain major and hard-pressed governments. It asks that such assistance be available only under extraordinary circumstances, that its terms and conditions be stringent and that there be direct State involvement in the rapid restoration

of the financial integrity of the recipient of the assistance.

The resolution is not aimed at creating a large-scale or indiscriminate extension of Federal credit assistance to States and municipalities. The great majority of governments prefer direct use of a free market and they are both willing and able to finance themselves in that market, if market conditions permit. But, unfortunately, the market for state and local securities is in general despair and, for some, it has ceased to function altogether. Because of the depressing psychological and economic effects of a massive default -- already much in evidence just in the anticipation of such an event -- market conditions are exacting a heavy toll on all governmental borrowers, restricting credit and pushing our costs of borrowing to unreasonable and intolerable levels.

Not all of the problems of the municipal market are attributable to New York City and State's difficulties. But their financial trauma and the sheer enormity of their involvement in the market are magnifying other factors that contribute to the present stringencies all out of reasonable proportion. Therefore, unless we can solve their problems in an orderly fashion and clear the air, there is a grave and unacceptable risk that losses of value and confidence will continue to drag down the market for all State and local securities.

Without the functioning of fair and rational market for our bonds and notes, State and local governments cannot operate effectively or efficiently in the interests of all taxpayers. It is they -- whether it be in paying back defaulted bonds or in servicing high-cost, but perfectly sound debt -- that will bear the burden for years to come. In these circumstances, a "beggar thy neighbor policy" is shortsighted and self-destructive and, ultimately, inimical to maintaining a national credit market for our State and local governments.



MUNICIPAL FINANCE  
OFFICERS ASSOCIATION

RESOLUTION

ON EMERGENCY FEDERAL CREDIT ASSISTANCE TO STATE AND LOCAL GOVERNMENTS

Recognizing the continued deterioration of the nation's municipal bond market, the obvious erosion of investor confidence in that market, and the vast uncertainties and costs involved in the occasion of a default on indebtedness by a major State or local general unit of government, the Municipal Finance Officers Association hereby resolves:

That the Congress and the Administration take immediate action to provide credit assistance to such State and local general governments that, having exhausted all other feasible legal and fiscal remedies, are no longer able to obtain credit from any other source and, therefore, are faced with imminent default.

Furthermore, the MFOA believes such assistance should only be provided, in the case of local governments, where there is active State sponsorship and supervision of the local government in question to ensure that the finances of that government will be so managed as to repay the indebtedness arising from Federal credit assistance as rapidly as is consistent with the continued provision of vital governmental services; and

That such credit assistance should not be used as a vehicle to subsidize the cost of borrowing or to lower it below that paid by State and local governments that have maintained their creditworthiness, but rather should be equal, at a minimum, to the full cost to the Federal government or its agencies of providing such assistance; and

That such Federal credit assistance should be so designed as to discourage any widespread use by governments and to restrict its application to extraordinary financial emergencies to which the only immediate alternative is a default.

Adopted October 8, 1975

Mr. URIE. The Executive Board of the Municipal Finance Officers Association has adopted the attached resolution calling for immediate Federal action to establish Federal credit assistance for States and localities that, in the absence of an ability to borrow in the capital market, are faced with imminent default.

The resolution is as follows:

Recognizing the continued deterioration of the Nation's municipal bond market, the obvious erosion of investor confidence in that market, and the vast uncertainties and costs involved in the occasion of a default on indebtedness by a major State or local general unit of government, the Municipal Finance Officers Association hereby resolves:

That the Congress and the administration take immediate action to provide credit assistance to such State and local general governments that, having exhausted all other feasible legal and fiscal remedies, are no longer able to obtain credit from any other source and, therefore, are faced with imminent default.

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That such credit assistance should not be used as a vehicle to subsidize the cost of borrowing or to lower it below that paid by State and local governments that have maintained their creditworthiness, but rather should be equal, at a minimum, to the full cost to the Federal Government or its agencies of providing such assistance; and

That such Federal credit assistance should be so designed as to discourage any widespread use by governments and to restrict its application to extraordinary financial emergencies to which the only immediate alternative is a default.

That is the extent of the resolution. The resolution essentially calls for a Federal lender of last resort. It is tailored to the immediate crisis at hand, one of an actual or impending insolvency that is caused by a lack of confidence, a lack of willingness, or lack of ability of investors to accept the uncertainties involved in lending to certain major and hard-pressed governments. It asks that such assistance be available only under extraordinary circumstances, that its terms and conditions be stringent and that there be direct state involvement in the rapid restoration of the financial integrity of the recipient of the assistance. The resolution is not aimed at creating a large-scale or indiscriminate extension of Federal credit assistance to States and municipalities. The great majority of governments prefer direct use of a free market and they are both willing and able to finance themselves in that market, if the market conditions permit.

But, unfortunately, the market for State and local securities is in general despair and, for some, has ceased to function altogether. Because of the depressing psychological and economic effects of a massive default already much in evidence just in the anticipation of such an event, market conditions are exacting a heavy toll on all governmental borrowers, restricting the credit and pushing our costs of borrowing to unreasonable and intolerable levels.

Mr. Chairman, the statement continues.

I will stop here and I think the other gentlemen on the panel have comments to make.

The CHAIRMAN. Mr. Fullerton?

Mr. FULLERTON. I am S. Grady Fullerton, county auditor of Harris County, which contains the city of Houston. I am a CPA. I would like to call the committee's attention to several facts and facets I believe

are important in the deliberations. There has been a traditional separation of financial powers between State and local government and the Federal Government. I believe the separation should continue.

The resolution we have presented is a compromise of a number of viewpoints. Some of the viewpoints are so strong as to say that the Federal Government should have nothing to do with this matter and let the State of New York and city of New York suffer the financial consequences. A number of commentators are now saying that if the city of New York defaults, it will have a serious impact on the financial community. The fact that the city of New York and State of New York is a significant percentage of the total municipal debt outstanding in the country, causes this problem to be viewed in a different perspective. I, therefore, believe that the U.S. Government should take some action.

I would limit the action to a one-time program to provide assistance to the city of New York with no provision for any other units of government, because of the impact of those units of government on the national scene, which does not approach the impact of the city of New York.

I am concerned about the tax-exempt status of local government bond being maintained. This is a vital factor in local government financing. There is a quid pro quo. In the past the local governments have not levied taxes on the Federal Government and Federal Government has not taxed the interest income on local debt. Every city and county provides services for the Federal Government that would be compensated for by taxes, if the Government were operated as a private industry.

I do not wish to change this. I feel the present environment is appropriate, but the continued assault on tax-exempt status of State and local bonds causes me concern.

I would suggest there are ways of approaching this that would include the use of the Federal courts by enacting legislation to permit the matter to go to a Federal district judge and have him surprise the debt of New York City, as it is worked out.

This position of MOFA is a compromise between many extremes. I support the resolution, but I recommend that any action taken by the Federal Government be extremely limited and the strongest controls be maintained by the Federal Government over the operations of the city until the city is again solvent and is able to meet its debt as it matures.

I would like to say a couple of other things. I would like to offer testimony to you today that is 180 degrees variance with some of the testimony you heard yesterday.

I would assert there are generally accepted accounting and reporting standards applicable to units of local government. They have been documented in the accounting literature for years. In 1936 the Municipal Finance Officers Association published a textbook called "Municipal Accounting Statements." That book was updated in 1951, entitled "Municipal Accounting and Auditing," published by the Municipal Finance Association. That book was again updated in 1968. It is called "Governmental Accounting and Financial Reporting," published by the National Committee on Governmental Accounting.

The Federal Government itself had representatives that worked on each of these books as they were published. The American Institute of Certified Public Accountants has recognized this as being the generally accepted accounting standards for units of local government. The American Institute of Certified Public Accountants published an industry audit guide. It became effective for fiscal years beginning January 1, 1974. Every audit report published by a firm of independent certified public accountants contains a statement such as Harris County's audit report, such as the city of Houston's audit report. Both of the entities are audited by firms of certified public accountants with national reputation. The public accounting firm takes the statements of management as prepared by the chief financial officer of the unit of government and audits them. The public accounting firm says, "we have examined all these financial statements and in our opinion they are in conformity with generally accepted accounting principles applied on the basis consistent with that of the preceding year," the same way as any nationally-owned company whose stock is traded stock on the New York Stock Exchange.

Many units of government are so audited. The Municipal Finance Officers Association has long advocated not only basic accounting statements, but supplemental accounting statements to provide all of the information that bond dealers, rating agencies and investors would want. That is what this book does. It goes into detail, not only of basic accounting statements, but a great deal of supplemental information, including 10-year summaries of tax collections, levies.

I was utterly amazed to hear the Governor of New York State if we had the records we would have known the city of New York was in bad shape. I was utterly amazed to hear financial advisers of outstanding reputation admit that they had invested millions of dollars in the city of New York securities without having financial statements to back them up.

MFOA has done a great deal of work along this line.

Mr. Petersen will talk about a credit study we have made. We have been involved in a great many training sessions for helping municipal financial officers do a better job. For instance, every time the Sun comes up I would like to think we have earned \$31,000 on the interest of temporary surplus cash we have invested and not letting it lie idle in the banks.

The information that the bankers need and investors need is available. All they have to do is ask for it. There has been a breakdown in the basic systems of checks and balances in the fiscal controls of the city of New York.

One thing I would caution you to be careful about is the integrity of the estimate of revenue. One of the games that financial people play is to overestimate the revenue. Then, when it does not yield—whenever the yield from the estimate of revenue doesn't meet the estimate—they have, in effect, overspent the budget that year.

So, whatever plan you come up with, control of that estimate of revenue is vital. I feel you must keep the city of New York's feet to the fire as long as there is any Federal involvement. There must be rigid and unyielding fiscal discipline. There must be a failsafe mechanism that the city and State will keep the commitments they agree to. They are willing to agree to almost anything now to receive Federal

assistance. Once they get the assistance, it must be monitored with enough clout to see that they comply with the terms of the agreement. I recommend you invite the American Institute of Certified Public Accountants to submit comment about generally accepted accounting principles applicable to units of local government.

I believe you can find creditable men who will support what I have said to you here. Senator, the local government can operate in a fine environment. I suggest to you the annual report of the city of Milwaukee, Wis., which has a "AAA" credit and has won the coveted "certificate of performance," which says its financial report conforms to the principles set forth in this textbook.

Mr. McCann is certainly outstanding in the field. He will testify to you, yes, there is a way of getting all of the financial information that the bank and bankers need. It has been made available to them.

I feel, in summary, that perhaps the Federal court would be the best place to monitor this retrieval of New York City from a bad situation. But because New York is so big and it will have an impact on the market I feel the Federal Government should make some steps in this direction immediately.

Mr. TORRENCE. Senator, my remarks will be very brief. I'm Joe Torrence from Nashville, Tenn. I'm past president of MFOA. I am currently chairman of one of the important standing committees of the association, the committee on public debt administration. We on the committee have been watching, and as far as that is concerned, thousands of members of MFOA have been watching the New York situation closely for months and months. I think I would like to reiterate two points. I suggest that congressional action here and now be taken to solve New York's crisis as a one-time single solution to a single problem.

The situation should not be used as an opportunity to completely reorganize the tax-exempt market and drastically change the whole scope of Federal, State and local government relationships.

If it is time for a change in these relationships, by a new policy at the Federal level, it should be done separately from the New York case and be done in a more calm, less crisis-like situation.

Another point I would like to reiterate is that any Federal assistance program to New York or any other such case, where there is default or near default, be afforded only when the State government is involved in a major way of responsibility. I say that because I think it is highly important that the State government some way or another be included in these situations. In my own personal opinion, I feel that probably to some degree all of the troubles of New York City have come about as a result of direct relationships between New York City and the Federal Government, wherein the State had nothing to do about it or knew very little of what was going on.

Thank you very much.

The CHAIRMAN. Thank you, sir.

Mr. PETERSEN. Thank you Senator.

I will try to make my statement equally brief.

Reference has been made to a study that the Municipal Finance Officers is sponsoring and now conducting. It is under a grant from the National Science Foundation, having to do with the planning for

Mr. PETERSEN. No.

Mr. FULLERTON. Senator, there are members of the executive board who feel almost that strongly, but in view of the total aspect of the problem, they came to a compromise that this resolution is fair, and support it. We would like to see the Federal Government stay out of it. But this problem is of such magnitude we feel you should help.

The CHAIRMAN. You said the assistance should be immediate. Can you explain that? Why is it necessary, in your view, to be immediate?

Mr. URIE. Quoting Will Rogers, all I know is what I read in the newspapers. It looks as if default is imminent within the next 60 to 90 days. If steps are to be taken to prevent the default, they will have to be taken rapidly or default will have occurred.

The CHAIRMAN. We should pass legislation as quickly as we can. Steps would have to be taken after the legislation is enacted. You say State sponsorship is necessary. What does that mean? Would you regard—you were present this morning. Would you regard what the State of New York has done so far being what you have in mind?

Mr. URIE. All local units of government are creatures of the State. Generally, we like considerable autonomy. We fight for that out in the States. When you are facing the kind of situation New York City is facing, where default is imminent, then we feel we must give up the reins and accept guidance and control from the State level.

The CHAIRMAN. You said that the action should not subsidize the cost of borrowing. Obviously if you provide a guarantee and that is all, the present obligations or instruments like it, you would be subsidizing the cost of borrowing because it would be at a far lesser rate than anything else. What would you do?

Mr. URIE. Go to a taxable bond.

The CHAIRMAN. You support a taxable bond. I wasn't sure about that. I thought Mr. Fullerton opposed a taxable bond.

Mr. FULLERTON. Not in this case. Where the Federal Government is putting up the guarantee, then there need be no tax exemption.

The CHAIRMAN. In addition to that, the Federal obligations now, particularly compared to the kind of rating New York has had over the last 5 years, are at lower yields even though they are taxable, than the nontaxable New York obligations. I take it you might accept as appropriate under these circumstances, a premium to be paid to—perhaps for the service costs and so forth?

Mr. URIE. Yes; that is what we are suggesting.

The CHAIRMAN. What action do you think would be appropriate to protect the Federal Government's interest, so that it would be unnecessary for the Federal Government to take a significant risk under these circumstances? I have difficulty eliciting much of an answer from the Governor, although I thought he did a fine job, and Mr. Rohatyn. On that score, they are a little bit unclear in my mind.

Mr. URIE. I'm not sure I can answer that question. I will open it up to all members of the panel.

Mr. TORRENCE. This may be a far-fetched, theoretical thing, but in the first place, I don't believe that the Federal Government has a part to play in this matter unless it really is determined that a crisis exists. With reference to New York, in this case, that is so far reaching in its impact that it has widespread disadvantages to other economic situations. When the impact is in that category—if it is, and I think it

is—then I think that the Government, Federal Government, surely is justified to move in for the general welfare, and do whatever is necessary, even if there is a risk of the Federal dollars involved. I think there is precedent for this everywhere you look.

The CHAIRMAN. I'm inclined to agree with that. But we have a selling job to do with the administration and our colleagues. I think one of the prices that may have to be paid for this is we have to have positive assurance that the Federal Government will not have to make the guarantee good. You are experienced finance officers. You have more experience and better judgment in this than the Members of the Senate. Are there suggestions you would make to at least reduce the risk of the Federal Government, if not limit it?

Mr. FULLERTON. I would like to suggest that the estimate of revenue is the key. A Federal district judge with supporting assistance as he would have—advice coming from all sources—could say, based on this tax package, that it is his considered judgment it will yield this number of dollars. He could say, "City of New York, here is the maximum amount of money you can budget this year."

The CHAIRMAN. You say a Federal court?

Mr. FULLERTON. In the event of bankruptcy, perhaps.

The CHAIRMAN. I wonder if a court would have more competence than the kind of people the State of New York has assigned. I'm impressed with the kind of people the State has assigned. I have great faith in our court system, but I doubt if they would be able to assemble that kind of information or superior competency here. Why would a Federal court have to supersede the authority and competence of a State like New York.

Mr. FULLERTON. Sylvia Porter writes a column in the newspaper. She also publishes a newsletter about interest rates. She points out in the current issue that there are several different advisory groups on this problem already, but they have no power. They are only advisory. We found a lot of times—

The CHAIRMAN. The Municipal Assistance Corp. has present power. They have the power to veto expenditures by the State, power to veto additional—Emergency Financial Control Board, I should say. They have power to prevent any wage increase. They have power to prevent capital expenditures. It is a massive power.

Mr. FULLERTON. Senator, I feel the district judge, in handling this case and seeking advice from the same sort of people, would have the Federal court backup and control. I think assistance will have to be monitored. It is like a man—an alcoholic wanting another drink. He would say, "Give me money and I will promise you anything." Once he gets it, he takes off on a spree again.

The CHAIRMAN. Do you think there are problems because the State is involved and the State is involved with the same constituency and, therefore, it would have less disciplinary force?

Mr. FULLERTON. I really feel when a private corporation goes into bankruptcy—

The CHAIRMAN. The question was how do you do the job without default?

Mr. FULLERTON. They are already there de facto. The city of New York has been unable to meet its debt as it matures. It has gone to extreme measures.

The CHAIRMAN. It may be de facto. They are not in default yet. That is what we are trying to stop.

Mr. FULLERTON. They could apply, with certain enabling legislation, to a Federal court to take over and say to creditors, "stand back until we can get this thing worked out." But, it would take enabling legislation.

The CHAIRMAN. Don't we want to avoid that? When you say creditors stand back until we work this out then not only New York is in trouble but all cities and States in the country are in trouble because the potential investors would say they have been told by a court in New York to stand back. They are not able to protect themselves. Why not proceed with guarantee and supervision coming from the Federal Government on top of the State's responsibility?

Mr. FULLERTON. I would accept that. I want to be sure there is enough supervision by the Federal Government to guarantee that the State will perform and the city of New York will perform, that they will not be allowed to take the money and go their merry way.

The CHAIRMAN. I understand your position. Now you say there is a common tendency to overestimate revenues.

Mr. FULLERTON. Yes, sir.

The CHAIRMAN. That is helpful advice for us. I have that feeling. I don't think it had been explicitly called to our attention before. Precisely how do we prevent that kind of thing? There are, after all, legitimate differences of judgment on revenue. We have failed to estimate our own Federal revenue repeatedly.

Mr. TORRENCE. Senator, I don't know if it would work on a Federal level, but in some local jurisdictions and in mine particularly there is spelled out in the charter of our local consolidated government the specific provision that the director of finance is the only person who can certify revenue investments. I have had that challenged in times past. Where there is no provision for this kind of certification that presumably cannot be toyed with, there is a tendency to be liberal in your revenue estimates and in local governments when budget time comes and drastic things are being considered to be dropped and sometimes this includes people on the payroll, at the local level, there is tremendous political pressure to do something. To overestimate is one of the things easy to suggest. We have a local option sales tax and in our past budget we were urged by the school people, because it so happens that the sales tax is earmarked for public education, more than once to be liberal in our estimate of revenue for local optional sales tax. The truth of the matter is in our last budget, I think I probably was \$500,000 too liberal, but that is yet to be seen.

The CHAIRMAN. Couldn't that be handled by taking the historical record, seeing what was received in tax revenue in the most recent period and then making the most careful and conservative adjustment as to increase and being well aware of making full allowance for obvious decreases.

Mr. TORRENCE. Whoever certifies revenue should not feel put upon if he is called to explain his estimates and his explanation is what you have to go with. Past experience plus any change in local economy or legislation or what have you that will influence it.

Mr. PETERSEN. There are a lot of ways you can do this sort of thing. I think the city of Atlanta can only appropriate 98 percent of

the previous year's tax collection. Any additional appropriation they have to do on a supplemental through the tax year as the money comes in. It's like a PTA budget where you will decide you can budget only 80 percent of the anticipated revenues until the money is in hand. In terms of the Federal Government being assured of getting its pound of flesh as security, there were discussions this morning of using revenue sharing. How do you tie in revenue sharing? Perhaps use that as a form of security, as a form of execution money to make sure borrowers are living up to the terms of the loan condition.

It seems to me, as Mr. Torrence pointed out, that the committee is meeting to decide the national interest here. I find it inconceivable that roughly 20 percent of State and local governmental debt will be renounced, especially to the Federal Government. We have here a cash flow problem as much as anything. New York needs a bridge loan. That is how we see it, and, believe me, it has been difficult to work out our compromise position.

The CHAIRMAN. My understanding is that the guarantee should solve the cash flow problem. Presumably if they get a guarantee they can raise the \$5.1 billion they need in the next 6 months.

Mr. PETERSEN. It looks like the only thing to solve it unless they can dragoon in pension fund money or do other things which probably won't be sound policy even were it politically possible.

The CHAIRMAN. Then the question is, as Mr. Fullerton properly said, how do you hold their feet to the fire during this period. I'm somewhat inclined to feel that maybe the guarantee should go only to the short-term obligation so if they failed to live up to the agreement you would threaten to cut it off and make sure they stay in line. One of the purposes of this is to move New York out of the short-term market into long-term obligations. That is the reason they are in trouble. If they did what every other city does, which is to finance their deficit with long-term money, they wouldn't have gotten into this serious problem. What is the best way to stay on top of this and to make sure once the guarantee comes through they won't relax and you get the unions coming in and getting big compensation, hiring freeze is off and you begin to get in trouble again. How do we prevent that?

Mr. TORRENCE. I didn't try to rebut Mr. Fullerton on his idea. Even though he would suggest a Federal judge as being the monitor of this thing, he agreed that the State—as in the case of New York, which is coming in with a strong setup of control—can monitor it. I think it's important. I am for the Federal monitoring and done effectively. I am not sure in my own mind whether it should be a Federal judge or some other setup. I feel very definitely sure that in these situations wherein they are so drastic that the Federal Government has to come to their assistance. The State ought to be a party all the way through.

I think the local government before it can be eligible to apply for the Federal Government assistance, has got to go to the State and every effort has to be made at the State level to work the situation out before they go to this, what I call court of last resort.

The CHAIRMAN. Mr. Urie.

Mr. URIE. Senator, I think some of the mechanisms already established in New York are good. The board of control is an excellent mechanism. However, I must say that we all have those same kinds of problems in every city. We do have a lot of pressure from the unions.

We have just completed a strike of our firemen in Kansas City, Mo. They agreed to go back to the fire stations and we are now at the negotiating table again. We were prepared for a long strike. We brought in the National Guard and volunteers and we were prepared to hang on for a long period of time. The firemen found they would not have public support and they felt that some lawsuits were hitting them pretty hard. They agreed to come back to the bargaining table.

We do have those kinds of problems. I can't say we will always handle them 100 percent of the time. But somebody has to take a tough stand in those situations. They have to face them. One of the unfortunate things in New York City and other cities is that your community leadership, once they become affluent, go to the suburbs and you lose the leadership living in the city.

The CHAIRMAN. On monitoring, we must have a prompt and accurate report so we know exactly how much is being disbursed, what the obligations are if they change, and what progress we are making or not making.

Is there anything else we can crank in here?

Mr. URIE. We have a system of quarterly estimates where we try to estimate, each quarter of the fiscal year, revenues to the end of the fiscal year and expenditures at the end of the fiscal year.

Last year we found we had a shortfall of revenues. We did not collect as much as we estimated, it turned out.

We immediately took steps and started freezing positions well in advance of getting into any financial difficulties. You have to have an accounting system that gives you advanced warnings. This is one of the things that New York lacks.

If they had followed the accounting concepts we have in Kansas City, they would have had advanced warning and could have taken steps to correct these things years ago.

The CHAIRMAN. You need the information on a timely basis. When you get that information, you need the continuous supervision as long as there is a guarantee in the hands of the Federal Government to prevent any increase in expenditures, a negotiated union increase, for example, or capital expenditure that would be a burden: anything of the kind that would disrupt the situation and endanger the progress toward a balanced budget.

Mr. URIE. Right. Force them to live with the financial plan that they have made to bail themselves out of the situation.

The CHAIRMAN. Mr. Torrence, you said this should be a matter of Congress acting now on a one-time basis. It should not be done as part of the general problem.

We have a number of Senators—Senator Cranston, Senator Jackson, Senator Humphrey, and others have put in bills, and every one of them is a general bill.

The feeling is understandable. It is hard to justify things for one State or one city. A great majority of Senators, 98 out of 100, come from other States and other cities. We don't see why we should do it for one group and say if the situation develops for Wisconsin, Texas, Alabama, or any other State, that they should not be entitled to the same treatment.

I understand your feeling that this should be ad hoc. At the same time, you are a gentleman with experience in politics. You can under-

stand our difficulty, perhaps, if we try to confine this to a single shot at the New York situation alone.

Mr. TORRENCE. I think I didn't make myself entirely clear on that point.

What I had in mind was that this be an effort on the part of the Federal Government to deal not only with the New York situation as it exists, but to set up machinery by which this situation can be dealt with now. If, by chance, there are others down the road that we don't know about, you will already have a system by which to deal with it.

What I was trying to make clear is that I hope that the Congress will not, on the occasion of this rare, traumatic situation in New York, come in with a broadside of legislation that attempts to do more, having to do with the tax-exempt market, and having to do with this whole business of our balanced federalism between local and State and Federal Government, which indirectly it involves.

I would hope that the Congress would deal with this as a particular problem. Just now it affects New York and New York City. Next week or next month—I hope not—we could have the problem somewhere else. That is what I had in mind.

I hope that the legislation which finally comes forward from the Congress will deal specifically with this kind of situation and not be a broadside effort to redo the whole tax-exempt market and be a drastic change in the relationship between Federal, State, and local government that has existed all this time.

The CHAIRMAN. Mr. Petersen, you told us about the helpful National Science Foundation study that is going on now, as I understand it.

Has that developed any information which would be useful in this case?

Mr. PETERSEN. Senator, I believe it has. The work is in progress. We actually started with the research itself in May. We have, as I said, devised model guidelines for official statements.

There have been for years official statements promulgated. In many cases they weren't read and in many cases they were not understood. We have surveyed the entire area for a couple of months, what the investors and underwriters are getting in the form of a prospectus, in order to analyze thoroughly to what use the information is being put and how to better provide the information.

We are trying to provide information that develops good security analysis and limits our exposure under the antifraud provisions of the Securities Act. That is one phase.

Another phase is to develop what is sorely needed, good leading indicators to fiscal conditions in cities, counties, and States throughout the Nation.

This is an area, quite candidly, where there has been little work done. For years, the market rolled along taking the credit ratings pretty much as given by the agencies, not doing a lot of their own analysis.

We have data problems in the State and local government area in many cases. What we are trying to see is how more mileage can be gotten from the available data. We have been in a period of sustained growth in the State and local sector, occasionally with fiscal stress, but certainly the strongest sector in the economy.

Now we have plateaued. In some cases, there has been entrenchment going on. For the first time, analysts are dealing with a different economic phenomena in this sector.

How do we deal with this? How do we evaluate this? There are many other aspects to the study; it is a multifaceted study.

As I pointed out earlier, we will be providing information to the committee as it flows along. We are studying the impact of various insurance programs, something that has been spoken about earlier.

Senator Jackson's bill contains a section of reinsurance of private carriage of municipal bonds. We have two private carrier insurance programs in operation now. We are doing a cost-benefit analysis on this.

How do the premiums really compare with the saved interest costs in this particular case? They are technical studies, but I think they will have a great deal of policy value, Senator.

The CHAIRMAN. You gentlemen, I think, represent as expert and responsible a group of witnesses as we will have in this area as far as the situation of the lenders are concerned, and also recognizing the importance of fiscal integrity and responsibility on the part of municipalities.

One objection to this kind of guarantee is that it could induce not only investors who ignore risks in the future because they might assume that if somebody gets into difficulty, the Federal Government will come along and guarantee them. Why worry about ratings? What difference does it make? Why worry about whether or not a particular city had been operating within a budget plan and had been responsible or not?

The Federal Government will guarantee they will take care of it.

There is one way to continue this discipline. It would be to provide a limited guarantee with a penalty involved that would have at least a modest, limited adverse effect on the people who have the securities.

This would also act to keep the cities, it seems to me, keep them on their fiscal toes in the future as well as keep investors aware of the fact that good judgment and care in investment will continue to be necessary in this field.

What is your reaction to that?

Mr. URIE. Senator, in the financing of any city in the situation where the city needs the help, if their bonds are removed from the tax-exempt market and they have to pay the cost, that will be enough of a penalty.

We don't think there should be a punitive penalty in addition to that.

The CHAIRMAN. Why should the investor be concerned with quality in the future? That is the fundamental discipline for persuading people.

I have heard municipal officers argue that they have to hold down expenditures, they have to be fiscally responsible. They have to worry about capital investment. They want to maintain their rating.

Will they be able to forget about their rating if we go ahead with this?

Mr. URIE. No sir, and the last paragraph in our statement says that such credit assistance should be so designed as to discourage any widespread use by governments.

If there is an occasional situation where Federal guarantee has to come into play, they will not affect the overall municipal market.

The CHAIRMAN. Why won't it affect an investor? It is a precedent. If you say yes to New York, it is hard to say no to Peoria.

Mr. URIE. They will not be in the tax-exempt market.

The CHAIRMAN. But they started off in the tax-exempt market. If they came in late, they will get a pretty handsome premium.

Mr. URIE. It will cost them if they go out of the tax-exempt market into the taxable market. It will cost them. If they also pay the cost of the Federal guarantee, it will cost them.

The CHAIRMAN. Suppose an investor came along 3 or 4 months ago and bought some of the New York obligations. He was able to buy them at a pretty good premium, maybe \$60 for \$100 bond.

He will be making a beautiful profit on this. He is doing it on the basis of really ignoring the quality and the rating and so forth.

Is that fair to give him that kind of capital gain?

Mr. PETERSEN. Senator, for the first time I can recall in Senate proceedings we are talking about municipal bonds as hot issues. That is the thing we are trying to prevent.

If that investor had bought New York City or State bonds a month ago he wouldn't be looking too good today. That is the problem. It has been going down and down. It can be a self-fulfilling prophecy.

Your statement is directed to Peoria.

The CHAIRMAN. He would be looking good if we provide a guarantee.

Mr. PETERSEN. If.

The CHAIRMAN. We may provide that guarantee.

Mr. PETERSEN. I am not sure the bondholder will look that good, but the noteholder, yes. If you are sitting on a 20-year New York City bond—

The CHAIRMAN. If you get a guarantee everything is good.

Mr. PETERSEN. Credit assistance given to this city and State over the next 5 years will not change the basic deterioration of the economy of that city. Noteholders are a different situation. That is true.

We are talking about a way of meeting their payments.

The CHAIRMAN. I have heard those complaints from responsible members who want to help. They don't want to be in the position of assisting those who were speculators.

It is hard to not discriminate.

Mr. PETERSEN. If we could isolate the problem to New York City and the New York City noteholders, we can dismiss the proceedings.

But we are talking about the impact to the rest of the market. Money is going from other tax-exempt bonds and we are having to compete with higher rates with the other securities and it is harming other borrowers.

Mr. WEINTRAUB. We have a problem of—which has been raised by a number of people whereby some people bought New York City notes with their eyes wide open and we are getting 9 percent returns on them.

There is a risk involved in doing that.

We are coming to the point where we say let's guarantee New York City securities through a State agency which would reimburse these people dollar-for-dollar when their notes mature.

That is an invitation of sorts for continued attention, overattention to yields and underattention to risk.

Now, how do we deal with that.

Mr. FULLERTON. I think your point is very valid. I bought a New York-New Haven Railroad bond the other day. I paid \$40 for it. I bought it with my eyes open. If you do not pay the notes off at par when they mature, then the city is insolvent.

I don't know that there is a lot you can do with speculators.

On the basis of Government testimony today, there will be a number of insurance companies buying those bonds saying, hey, they will bail us out at par.

I think the Senator asked a question a moment ago I would like to respond to. Any enabling legislation would say to the local government that you must or you are mandated to follow the accounting principles of the financial reporting standards as promulgated by the Municipal Finance Officers Association of the United States.

This is necessary, that you keep your books where we can read and find out what is happening.

I would have you say those units of government must be audited by independent public accountants who will express their independent accountants' opinions on the financial statements.

The CHAIRMAN. That has not been the case with New York City.

Mr. FULLERTON. No.

The CHAIRMAN. They have not had independent CPA reporting and they have not used the principles of yours.

Mr. FULLERTON. That's correct. I have seen their financial statements. It is astounding.

I could not make heads or tails out of them.

Mr. WEINTRAUB. Let me ask you this question. Suppose we could find a way and maybe you can help find a way in which instead of giving back dollar-for-dollar to the noteholders as the notes mature, we gave back something less than a dollar.

Suppose there was a way to do that, would you favor it?

Mr. FULLERTON. The Government has said we want to borrow your money and on January 1976 we will give your money back. Any failure to do that breaches the faith in the Government.

The CHAIRMAN. If we had that it is default. You have all the consequences of default in the municipal bond market all over the country.

Mr. FULLERTON. Every time somebody dies the undertaker makes a profit.

Mr. PETERSEN. It is a question of ethics. The reason we are here is because of the severe doubt and worry about the pledge to pay made by State and local governments; 99 percent of the cases it is a needless worry.

We are all suffering because of that.

The transitory gains that some might enjoy because they bought depressed obligations are small in terms of the potential national costs. They are doing nothing more than following the preachments out of Washington. Establish and keep a private market going for the bonds.

That is where the market was.

Mr. WEINTRAUB. Surely it is de facto and not de jure default.

It may be a healthy default.

Do you agree it may be healthy to do this in this case?

Mr. TORRENCE. It seems to me that if this approach is contemplated, I believe I would take another look at letting them go into default. Because default is the result of some sort of a catastrophe.

You are talking about a planned bailout that really doesn't solve the problems as far as the market is concerned, and certainly not as far as New York is concerned.

The CHAIRMAN. From a political standpoint, it could be bad, because you have the worst of both worlds. You have default on one hand, and bailout on the other. We are in a tough position on this committee. If we provide for the guarantee, the people who think that New York has been an improvident prodigal son, and uncle shouldn't bail them out, are mad at us.

If we let New York go down, then the prudent property taxpayer in every town, village, and city of the country is going to say, "You idiots, you could have prevented this increase in the property tax, and municipal bond rate by providing for a guarantee." You understand those circumstances; it seems we have the worst of both worlds.

Mr. FULLERTON. Senator, I think that is the reason some come to the conclusion that the U.S. Senate would be very wise to check this to the Federal court and let the Federal courts work out the bankruptcy.

Mr. URIE. I would like to speak to your earlier question. I don't know the extent of the speculation in these bonds. Historically, most municipal bonds and notes have been held by institutions, commercial banks, and other institutions.

Only recently has the market changed so there are more individuals in the market. I'm sure there is speculation in New York bonds and notes. I do not know the extent of that. I think it's very small.

I think if you render assistance, you are rendering assistance to the holders, institutional holders of those notes and bonds, and most of the holders of the notes and bonds are your citizens of New York City, either individual or corporate citizens.

There will be speculation on the side, but I would presume it will be small.

Mr. WEINTRAUB. There is a difficult question here. If you come up with some sort of rescue plan which makes whole the present holders or investors in New York City securities and puts the entire burden of the plan, the entire cost on the residents of New York who are not holders of the securities and on the employees of the city of New York, you are going to run into a difficulty that way.

It seems there has to be a share go here. It seems to me to be healthy from a standpoint of correcting from future imprudent investment decisions that don't pay enough attention to ratings and risks.

Mr. PETERSEN. If they hold them to maturity, they will have to pay capital gains. So there is a little more Federal revenue for you. State of New York has a capital gains, too. They will get back a little bit. Otherwise, it's a dilemma.

Mr. WEINTRAUB. Presumably when they bought the security, they understood what the yield to maturity was.

Mr. PETERSEN. On the presumption they would be paid.

The CHAIRMAN. Mr. Weintraub has a good point. It is true; you can understand how the employees and taxpayers of the city, if we pose an additional tax, as Chairman Burns proposes or we continue to hold down wage increases and prevent rehiring, which would be necessary—I frankly do not see what you can do about it. I don't think that in order to do justice and prevent anybody from making a buck out of this thing, we precipitate what most people would construe as a default, and I think that would be a copout.

Mr. FULLERTON. If you permit a unit of Government to pay less than par for its matured debt, I will have difficulty selling bonds in the future. The next guy says, "I don't want to take a chance on you."

Mr. WEINTRAUB. Let's suppose we construct a new State agency called MAC 2, for want of a better word. We let MAC 2 issue securities in exchange for New York securities as they mature. These securities would have a Federal loan guarantee on them.

These securities could be issued to pay the same—to pay the same yield that treasuries of comparable maturities do, say less half a percent. That would be the penalty.

On their face they would be dollar for dollar, but their present value, if anyone went to sell in the after market, would be somewhat less.

Mr. FULLERTON. Would you force the present holder to turn in his securities?

Mr. WEINTRAUB. We would give him the option as they mature. He could do it or take his chance on the city paying him.

Mr. FULLERTON. If the city doesn't pay him, he steps into court and says, "Hey, city, you owe me money."

Mr. WEINTRAUB. What is the judgment he could get.

Mr. FULLERTON. I believe the constitution of the State of New York says that first money will go to the debt service, even before operation. That may not be practical.

Mr. WEINTRAUB. I have been told by a lawyer in New York who is dean of university law school is all that would happen in the case of those holding full faith credit securities of New York was they would get a judgment and the judgment would attach that part of city-owned property not being used for public purpose. That amounts to nothing.

In this case it would be an offer they could not refuse.

Mr. PETERSEN. This is a general obligation.

Mr. WEINTRAUB. This would be full faith and credit notes. You are not in default if the person has taken the MAC 2 security.

Mr. PETERSEN. If you presume to get the city of New York back in the bond market by the year 2000, I would not suggest that move.

Mr. FULLERTON. The minute they do not pay off 100 cents on the dollar when the bond matures, they are out.

Mr. WEINTRAUB. How long did it take Detroit to get back into the bond market after they defaulted?

Mr. FULLERTON. They did finally pay off 100 cents on the dollar.

Mr. WEINTRAUB. When they paid off 100 cents on the dollar, did they pay it with the interest that was lost in the interim period?

Mr. FULLERTON. I would assume they had to.

Mr. PETERSEN. I think they did in almost every case. Out of the securities that went into default during the depression, the final loss in municipal bonds was \$200 million or 1 percent of all the debt outstanding. That is, the securities that actually went into default and remained unpaid. That was infinitesimal. Most of them paid interest on the interest.

The CHAIRMAN. Gentlemen, thank you very, very much for most useful testimony. You've given me a great deal of information that I didn't have before. You have made a helpful recommendation.

Your organization is nonpartisan, I'm sure. It probably has less interest than any of the witnesses who appear. The witnesses who appear generally—a number are disinterested, but the Governor has a deep interest and bankers a deep interest. Nevertheless, it's a position that reflects what they represent and have responsibility for, and the Secretary of the Treasury has a particular interest in a sense.

You gentlemen, I think, come before us, it's true, concerned with the prospects for your cities. That, in a sense, represents all of the citizens of our country. All of us live in some kind of a municipality or county or State which may have to raise money.

Thank you very, very much. You have been helpful.

We stand in recess until a week from tomorrow, Saturday, October 18.

[Whereupon, at 3:55 p.m., the hearing was recessed to reconvene on October 18, 1975.]

[The following additional material was received for the record:]



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202 466 2774

October 17, 1975

Mr. Kenneth A. McLean  
Committee on Banking, Housing and Urban Affairs  
5300 Kirksen Building  
Washington, D.C. 20510

Dear Ken:

Enclosed are some items that you requested after our testimony of last Friday.

The Final Report on Planning For Research and Improving Municipal Credit Information and Credit Quality has served as the basis for the larger-scale project we are now undertaking for the National Science Foundation. (I referred to the report in our testimony and you are free to include it in the record if you wish.)

It has been underway only a short period of time, but we hope to have interim reports shortly.

Sincerely,

  
John Petersen

JP:dq  
Enclosure

F I N A L R E P O R T

PLANNING FOR RESEARCH ON IMPROVING MUNICIPAL CREDIT  
INFORMATION AND MUNICIPAL CREDIT QUALITY

JOHN PETERSEN

Co-investigator, Municipal Finance Officers Association  
and

RONALD FORBES

Co-investigator, State University of New York at Albany

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A P P E N D I X

Proceedings of the user/researcher seminar

National Science Foundation  
Grant No. GI-44097

November 30, 1974

## I. PURPOSE AND CONDUCT OF THE STUDY

INTRODUCTION

This report is organized into three sections. This first section discusses the purpose and conduct of the planning study. The second section presents an agenda for research in the area of municipal credit information and quality and serves as a summary of the planning period's conclusions. Section three presents a detailed review of the individual project reports and the comment received upon them, as well as conclusions by the coinvestigators.

Appended to this final report are proceedings of the user/researcher seminar. The individual project reports, publications, and other materials under the project have been distributed and are available upon request.

PURPOSE OF THE PLANNING PROJECT

The growth of capital outlays by State and local governments has engendered increased demands for funds from the capital markets. While vast amounts of capital have been raised, market participants and observers have noted that risk premiums paid by many borrowers have been inordinately high relative to the actual level of defaults. Contributing factors to this are a lack of adequate and reliable information about borrowers and their projects, and, collaterally, a lack of knowledge on the part of borrowers as to the criteria and information used in judging creditworthiness. While the market has expanded the need for an efficient information system, the existing exchange of information has developed in an ad hoc manner.

The need to achieve improved information and analysis is ever more evident and critical as the market for State and local obligations becomes

increasingly complex in the nature of financing arrangements. In part, this arises from the efforts of governmental borrowers to improve their creditworthiness and to lower their cost of capital through new borrowing techniques.

Several proposals have been made that would attempt to improve either the information about creditworthiness or the substance of the credit itself. Typically, such proposals usually are formulated to cope only with certain specific symptoms of the overall problem; they often reflect confusion over the appropriate components of credit quality, its measurement and how needed information can best be obtained and disseminated. As a result, there is no guidance in selecting the most efficient strategies to follow in this area and the alternative strategies themselves have been subject to little in the way of orderly and comparative analysis.

#### ORGANIZATION OF THE PLANNING PROJECT

Because of the inherent complexity of these questions and the diversity of the factors that must be considered, there was established a planning period to develop specific projects and priorities for subsequent research. In that five-month period, the two coinvestigators worked with a coordinate team of researchers, public officials, and market practitioners to investigate and appraise the current state of knowledge and to identify the more fruitful avenues of subsequent study and implementation.

The overall topic of credit information and quality was subdivided into the following project areas:

- A) An examination of the hypotheses relevant for defining the analytical framework to be used in the measurement of credit quality.
- B) A description and evaluation of existing credit information systems, particularly as they are (or, are not) provided by various State-sponsored and private information and debt advisory services.

- C) A survey and appraisal of the needs and uses of credit information and analysis by market participants, and how such information influences the investment behavior of these groups.
- D) A comprehensive analysis of the wide range of governmental and private programs and techniques that are designed to enhance the creditworthiness and/or the marketability of State and local debt obligations.

An organizational meeting of the investigators and selected advisors was convened at the outset of the project in early July to establish immediate research approaches and priorities. At that time responsibilities in each research area were assigned to one or more investigators. In late September and early October, draft reports were submitted in the respective areas. These reports formed the basis of workbook materials that were distributed to participants in mid-October prior to a seminar on the subject that was held the end of the month.

#### USER/RESEARCHER SEMINAR

At the seminar, held October 31, 1974 in Washington, D.C., the research projects were subjected to a comprehensive examination by a discussion group of 51 participants representing 45 different institutions and agencies. The participants were purposely selected to represent the broadest possible array of interests. It included representatives of State and local government, bond investment and trading institutions, the major regulatory bodies, governmental accounting and law firms, credit rating agencies, and academicians. (The seminar proceedings and list of participants are included in the Appendix).

The seminar had two major objectives:

- (1) To elicit substantive criticism of the planning reports of the proposed research, both by professional researchers and practitioners; and
- (2) To assist in the development of recommendations and priorities for subsequent research.

To insure a maximum of meaningful debate and to evenly distribute critical attention, a number of discussants were preselected to comment on the project areas, with blocks of time allocated for general group discussion. In addition to the seminar presentations, several participants contributed extensive written comment. The more substantive communications are included in the Appendix and proved of great value in developing the research agenda.

II. AN AGENDA FOR RESEARCH TO IMPROVE MUNICIPAL CREDIT  
INFORMATION AND CREDIT QUALITY

A. Improving Credit Information

Municipal Credit Information involves the process by which those who need to know the financial status of a governmental debtor discover what they need to know. Interest in such information is shared by both the creditor and lender, since defects in the process can be costly to either or both or, for that matter, to others with related interests.

The need to know takes on many variations. The investor supplied with adequate information can make a better appraisal of what he faces and thus should charge less to uncertainty given his risk-return objective. The borrower government is better equipped to plan and take steps to mitigate its weaknesses and to enhance its strengths. The citizen or regulator is in a better position to judge the effectiveness and prudence of government or investor.

1. NEED FOR RESEARCH

The reports and extensive comment in this planning report note several reasons that substantiate the need for research to improve municipal information practices.

Protection of the Market Function

The recent focus on regulation of the municipal securities industry, stemming from many concerns, has brought an immediacy to the question of information practices. A substantial impact of such regulation will be to generate a demand - already felt in its anticipation - for more information in a standard and timely format to protect both

investor and issuer and to accommodate an orderly and safe market. It is essential that governmental reporting - often late, haphazard, and incomplete - be attuned to supplying legitimate needs at a reasonable cost.

#### Changes in Investor Groups and Needs

The dramatic growth in the municipal securities market has introduced new elements of investor interest that are unfamiliar with the market. Most prominent is the individual investor who lacks sophistication in these instruments. Furthermore, there is ample evidence that swelling supplies of municipal securities may face restricted demand from the conventional sources, forcing State and local governments to increasingly seek out new investors. Correspondingly, they must be able to discern and satisfy the information needs of newcomers.

#### Changing Fiscal and Economic Environment

Collateral developments with the burgeoning of municipal credit demand are important shifts in the character of governmental finance and the economic climate in general. The more obvious trends in the former have been toward greater reliance on intergovernmental payments, more progressive and volatile revenue sources, and - in the bond markets - more exotic debt financing devices. In terms of the national economy, the historic rise in interest rates and other prices, juxtaposed with flagging real growth and output, presents untested waters for State and local fiscal systems. Investors, in particular, are concerned not only about the repercussions in terms of ability to meet debt service but, also, the implications of inflation for potential demand for bonds, which is an additional element of risk.

Continuing Inadequacies of Information Supplied to Traditional Investors and their Agents

Both pilot survey results and expert testimonials have verified the needs of present investors, underwriters, and analysts for more and more useful information. By his very nature, the creditor must charge a premium for ignorance as an added risk. Furthermore, timely and adequate information is taken as an indication of good management and attentiveness to investor needs, for which investors pay a premium. Complete absence of the information is not always the problem; rather, it is a lack of responsibility and mechanism to get it to the right place on time.

Improvements in Analysis in Part Depend on Better Information

Not only does the lack of information hinder the implementation of present measures of quality, it impedes the development of improved techniques. Changes in the financing of government and new forms of organizing the supply of services continually alter the concept of credit quality and invite changes in the techniques by which it is measured. However, the state of financial reporting is such as to hinder the kind of extensive comparative analysis that the market needs to function efficiently. For purposes of economy, the market tends to rely on traditional forms of analysis and to delegate much of credit judgment to two private firms, whose opinions it fervently follows. Still, all participants admit that the present summary and symbolic judgments, while adequate in many respects, leave considerable room for more refined analysis, both by the agencies and individual investors.

## 2. MAJOR RESEARCH QUESTIONS

Research in the area of municipal credit information must start with a careful examination of the present system, its shortcomings and how these might be met most efficiently. Specifically, the major questions are:

### What Types of Additional Information are Needed?

Putting together a list of the desired information is a complex job that must start with assessing the needs and uses of the various customer groups. The key group is the investor, since it is he that determines day-to-day in the market place the relative prices placed upon debt. Much, if not most, of the information the investor receives is through specialized agents - rating agencies, other professional analysts, and dealers - and their opinions and experiences are useful. Pilot surveys have indicated that investors and their agents do have opinions on informational deficiencies and needs, although such direct surveys must be carefully controlled to avoid bias in response. Also, it must be noted that investors' needs depend on their peculiar portfolio requirements. Closely akin, and evidently important in the municipal market, are the explicit (or implicit) perceptions of the regulatory agencies as to information needs and allowable risks.

An added dimension are legal requirements. These are based on more paternalistic notions of investor protection and on the realities of complex markets, where the overall health of the market may be undermined by the excesses or omissions of a few.

Meeting these requirements, in what is an emerging area of law, calls for an additional line of study based on both the conventions of the existing municipal market and the precedents of other securities markets. Practitioners all agree to the top priority of this work.

Additionally, there is need to elicit the needs of users with an eye toward potential improvements in the way in which such information is used.

Although one should not typify credit analysis as a hotbed of revolutionary thinking, the view of experts is that techniques have lagged behind the development of public finance and the market. One objective of research into improved information items (and systems) should be to foster, or at least allow, a broader and deeper development of credit analysis. Thus, information gathered should reflect the needs of improved analysis. While this presents problems because of obvious disagreements as to how one should ideally measure quality, the pilot research and discussion did identify a strong affinity for development of the cash-flow motif, as we shall discuss below. Participants also showed a distinct preference for an early-warning set of summary indicators, that would provide at least a base-line of comparability, and that could be reported quickly.

Some of the problems are simply ones of faulty distribution. Information items now created often do not get to people who could use them. This occurs because the responsibility has not been affixed or an existing information simply is not attuned to credit needs, although the added cost of making it so would be small. Thus a study of transforming existing data into that needed by the credit-oriented users, stressing national comparabilities, and how to get it to them would be most worthwhile. The current convening of the National Committee on Intergovernmental Accounting offers great opportunity for the development of better standards in this respect.

Last, it should be noted that the kind of information to be collected should serve the needs of various State and local government regulatory or advisory bodies. Progress in this area has been slow, but the potential for State correctives to ailing local fiscal situations and the State's general interest in local debt dealings are obviously positive factors in appraisals of credit quality.

In summary, the kind of data to be collected should depend on the intended user group's needs, both present and potential. Survey work should be supplemented with actual analysis of the data to test their adequacy. Sentiment seems to be for fashioning simpler systems, with maximum application, and concentration on cash-flow analysis.

As noted, the practical uses of credit-related information act as a constraint on the amount of data required and there seems to be great uncertainty over the advantages of developing big data systems for the purpose of credit analysis. More work is needed to demonstrate in detail how such information can be used and, in the absence of clearly decisive empirical tests, demonstrations will have greatest impact if they start with information items upon whose value there is reasonable consensus.

#### How Should the Information be Collected and Disseminated?

In addition to the types and amounts of information needed, the management, locus, and financing of the system need to be determined. Just as the adequacy of information varies greatly, so do the systems devised for its transmission. The most widespread and influential system at work now is provided by the private rating agencies, whose quality ratings are important in the primary market and hold sway in the secondary market. However, existing ratings do not serve all the needs of investors and analysts. By the agencies' own admission,

they likewise would benefit by a better system to supply information. Moreover, many borrowers do not pay the fee to be rated and they are not covered by the system (about 30 per cent of borrowers, accounting for 5 to 10 per cent of the dollar volume of borrowing).

Initial opinion affirms that the most logical place to start analysis of collection and dissemination problems is at the State level, where a pilot project has already gathered much data. Some States have relatively well developed (and well recognized) information systems and all States have the legal powers to improve or develop such systems. From the aspect of researchable experience, there is a wide variation for the analyst to study and evaluate.

The initial observations on a national information system are mixed. While there is desire for improved collection and dissemination of data to serve a national market, there seems to be more profit in strengthening the State's capacity first. The fundamental technical problem at either level appears to be one of comparability, timeliness, and enforcement of reporting. A first step should be assessing the feasibility of these attributes on a State or regional basis, before plunging into a national system. On the other hand, many items of analytical interest are collected nationally and these and their sources need to be catalogued and pitched toward bond market needs.

Last, research on the locus of reporting systems should be aware of the informational roles that, even in improved State and regional systems, will still reside with the local borrower. These are of primary importance in the new issuances of debt and, along with other elements of bond sales, seem to require specialized forms of technical support that are frequently missing at the local level.

### How Should the Improved System be Financed?

A difficult problem in research into information systems will be the imposing budget constraint based on tangible cost and benefits. Fragmentary evidence of such systems in the private and public sector indicates that there are benefits (that, certainly, is the opinion of professionals) that most likely could be shared between issuer and investor. Furthermore, cognizance must be taken of the safety and insurance aspects in terms of the long-term costs that may be extracted if investors lack confidence in the market, or regulation to protect them engenders increased and formal requirements, or legal developments create large loss exposures which relate to information and which might be catastrophic in their consequences.

Research should be initially directed toward enumerating those informational areas where improvements may be rapid and economical. A first and relatively costless endeavor will be the creation of more widely observed standards of reporting, disclosure, and due diligence in bond sales. More elaborate information systems in State, regional or national depositories will need to be justified and perhaps can be. But to be practical, this depends on better agreement on the data items most needed and full and timely reporting of financial data from issuers. Detailed comparison of existing systems is the best first step.

### 3. METHODOLOGY

Examples of the methodology required to satisfactorily answer the above research questions are extensively given in the background papers. But certain observations are in order.

The nature of the research area is such as to require an interdisciplinary approach with heavy doses of practitioner input. The problems in the

information area are only partially technological and, in many ways, reflect strong institutional and conventional barriers to change. Information problems are not new, although their consequences are taking new dimensions, and the credit system has learned to live with them, though at a cost. Only by direct involvement of those responsible for, and knowledgeable in, the various operations, can the analysis be both technically correct and convincing to those who will implement improvements.

Information cost constraints are fundamental to this applied research. While the capital markets operate by many conventions that seem to be less than ideal, its professionals are typically quite good with figures. Improvements need to be shown to be economically feasible as well as operationally possible and who ends up paying for them may appear to be an overriding consideration. But, the experience of both private and public systems demonstrates that market participants will pay for some improvements, either directly through subscription to services or indirectly with better bids on bonds. In either event, it is doubtful if dollar costs bulk large for feasible systems. Moreover, the substantial risks of ignorance or illegality justify an insurance element here and participants will pay the premium to mitigate the possibilities of loss due to information lapses.

## B. Improving Credit Quality

Credit quality can be narrowly defined as the likelihood an obligor will meet his debt obligations in full and on time. Obviously many factors can influence this likelihood and, in an operational sense, the definition is most closely observed in efforts to determine the availability of cash to meet a particular debt service payment. Factors which market participants believe contribute to that happy event strengthen credit quality; factors thought to detract from it, weaken quality.

Credit quality is not static. While it is usually thought of in terms of intrinsic fiscal and economic strength, its impact can be altered or offset by changes in the nature of the financial arrangement or the obligation. Thus, it seems appropriate to include such marketability factors as well in this analysis. In discussing the needs for and design of research in the area, we shall not rigorously distinguish between the quality and marketability aspects.

### 1. NEED FOR RESEARCH

Both borrowers and lenders have an active interest in credit quality for many of the reasons discussed already under their information needs. But certain specific research needs arise in the area of improving the quality of credit.

#### Influence on Borrowing Costs and Rates of Return

Quality is fundamentally important to governmental borrowers because it is a major determinant of their cost of borrowing and, in some cases, their ability to borrow, absolutely. Depending on a host of conditions, quality factors normally can account from 10 to 25 per cent of the cost of borrowing in terms of interest rate differentials.

Our interest is heightened because governments can take policy actions which influence the quality of their obligations. It is for this reason that borrowers find it worthwhile to discover what factors are held by analysts and investors in determining quality (and why public officials become upset if they disagree with these factors or cannot discover them). Investors obviously hold quality dear and base portfolio decisions on risk/return calculations that depend heavily on perceptions of quality.

#### Efficiency in Financing

Given the fact that credit quality can be altered or offset by various policy actions, it is important to know both what these policies may be and what their cost are. Such costs may be direct but, also, they may appear as constraints on other forms of expenditure or as potential weaknesses in other areas of fiscal responsibility. But unless one attempts their measurement, one has an inadequate basis for rejection or acceptance. On the other hand, improvements in quality or marketability may be relatively costless for the benefits received. Efficient decision-making requires, therefore, knowledge of both costs and benefits in this area.

#### Financial Soundness of System

At base, credit quality is important to both investor and debtor because it gauges the financial strength of the system, the absurdness of repayment. While post-World War II conditions have brought only isolated tests of quality, both those experiences and the widespread collapses of the depression era have demonstrated the monumental, protracted costs of actual failure or even widespread suspicion

of its likelihood. Accurate estimates of credit quality, therefore, tell us much about the stability and resiliency of both the State and local sector and those capital markets which tend to and depend upon it.

## 2. MAJOR RESEARCH QUESTIONS

Research in credit quality forms a difficult area for a variety of reasons. While the concepts of quality and what constitutes it are admitted on all sides to be difficult, the market to operate efficiently and economically, has adopted many simplifications and conventions that cause controversy. Research, therefore, is torn between determining the best way to satisfy existing perceptions of quality - as ill-defined as they may seem - or questioning those perceptions and testing their adequacy. In the absence of conclusive evidence to show superiority, as discussed below, the tension will continue. Applied research, to have an impact and to foster improvement, necessarily will march the middle ground to accommodate immediate needs and to generate support for understanding and change.

### What is Credit Quality?

Research must start with formulating a target for improvement and this necessarily implies a notion of credit quality and its measurement. The pilot efforts reported below studied three approaches to defining quality; namely, the development of logical-conceptual models, relating factors to an ability to pay; surveys of practitioners to determine their perceptions of quality; and examining actual market performance, attempting to empirically relate candidate quality factors to interest differentials. These approaches should not be mutually exclusive nor any method, definitive.

The most salient point learned in the planning period is that practitioners are generally more concerned with actual market performance than embarking on tests of its rationality.

Top priority in research calls for the development and testing of improved analytical models of credit quality based on projected cash-flow adequacy and the types of data needed for such measures. Not all data are quantitative, since legal and administrative factors are held important. Such a system necessarily would be multi-dimensional. As noted in the above section on information, a summary list of early-warning indicators of financial distress - explicitly and consistently built on a cash adequacy framework - might have greatest influence on present analysis. A thorough-going comparison - on a case study basis - with alternative measures, is an essential element of this work. Work on this question should be carefully checked with practitioners for both its validity or acceptability. But existing conventions should not have veto power; concepts can be changed as conditions warrant.

#### Investor Behavior Toward Quality

As previously indicated, the perception of quality as opposed to its actual substance is potentially a target variable for research. If it can be shown in the light of actual performance or logical possibilities that investors, through lack of information or faulty convention, do not maximize return for a given actual risk, then the benefits of quality improvement will come from its better recognition. On a policy level this involves the regulatory agencies that now depend heavily on existing estimations without the benefit of examinations of their accuracy.

Realizing that credit quality is only but one risk element to the investor, this research area lays a heavy burden on a deep understanding on investor objectives and portfolio behavior as well as the historical performance of the market.

While the investor orientation is an important feature of potentially improving both information flows and market acceptance of bonds, there are many difficulties in mounting a major study of investor behavior in this area. The crux of the problem would seem to be the need to originate much market and portfolio data not now available. The absence of secondary market trading data makes a direct empirical estimate of the marketability factor in investment decisions an historic task. By the same token, studies of realized return on defaulted securities, while of potential value, seem also to lack available data. The costs of developing such data sets would be great and deserving of a project on their own. Obviously without such extended risk/return studies, critiques of the rationality of either regulatory or investor constraints and behavior are, at best, difficult to substantiate.

Many of these aggregative problems can be avoided by concentration on a direct survey of investors, foregoing the costs (and losing the advantages) of studying objective data on market performance. Such survey work -- which has resulted in some promising preliminary results -- will require careful attention to questionnaire design and procedure.

However, to maintain focus in the overall agenda, interest in the investors' behavior as regards to quality is necessarily more directed toward what it can tell us about opportunities to better meet perceived and demonstrated needs than evaluations of the rationality of that behavior per se.

Policies to Improve Credit Quality and Marketability

Research in this area extends throughout the range of government decision-making and organization down to the mechanical features of bond design and sale. Obviously the studies of the determinants of quality vis-a-vis financial management and legal arrangements and their impact on the market will be suggestive of many changes that can be adopted to enhance quality and lower cost. Many candidates have been identified in the planning phase, but quantification or ranking of their benefits and, it must be stressed, costs needs to be done. The outcome needs to be a matrix, designed for application under numerous constraints, of fiscal and management variables that are controllable. This logically flows with the development of credit models noted above and their empirical testing for market impact.

All levels of government are candidates for alteration in financing arrangements that bear upon credit quality and financing costs.

A top priority must be placed on the analysis of forms of credit assistance - ranging from guarantees through shifting of functional responsibilities among governmental entities. These are increasing in number and complexity and present an assortment of often practical but sometimes costly alternatives to borrowers. The linkage to improved analysis of credit, as well as a research objective in itself, needs to be stressed. A prime example is the importance of earmarked State revenues.

Preliminary work demonstrates that the costs and benefits of credit assistance techniques are estimatable and of great significance to all

market participants. Surveys of investor behavior can be used to gain insight into observed performance and primary market data can be used to achieve quantification of the sundry techniques.

Studies of instrument design (marketability features) possess strong possibilities for improved matching of investor needs by borrowers and a clarification of the costs of certain features. Again, the backbone appears to be in the use of available primary market data in determinant analysis (to properly isolate a host of modifying factors), supplemented by survey and interview work aimed at major investor groups (and their agents). A time series study of bond sale timing factors, while in need of more specific development as a proposal, also holds promise for influencing policy and behavior.

Growth-related aspects are only part of the overall capital financing question, but they do represent a traditionally important source of demand for credit and possess special problems because infrastructure expenditures frequently precede the wealth and activity that will repay the debt. Moreover, the current focus on land-use and controlled growth introduces a special and immediate need to develop the capital-related aspects of such policies.

Focus on improvements in creditworthiness and market acceptance by changes in basic demands for capital and the division of capital costs between various private and public entities is important. It represents a natural complement to the study of how a government may better finance debt that it elects to place within its sphere and the immediate need for which is taken as given.

### 3. METHODOLOGY

The nature of the research dictates, as in the case of information systems to which it is intimately related, the need for an interdisciplinary approach, founded on an extensive involvement of practitioners. Data requirements are such that many questions can be studied and techniques employed in concert and there are numerous opportunities for cross-verification of findings.

A top priority requirement is the availability and use of statistical data on new issues, and, fortunately, those data are at hand. Equally important is the design and broad use of surveys of investor's preferences, work upon which is well underway, although the problems of appropriate sampling procedures remain to be met. Equally important is the development of governmental fiscal, and related data for purposes of organizing and analyzing the suggested forms of improved credit analysis, a task that ties closely to the information work previously prescribed. The field of opportunity is so large and complex that efficiency dictates extensive case studies and rudimentary applications prior to any full-blown data collection and analysis efforts.

III. REVIEW AND CRITIQUE ON THE PLANNING PROJECTS

The planning project set for itself two prescriptive goals for the design of future research: improving the nature and flow of information related to municipal credit and improving the nature of such obligations through either enhancing the creditworthiness or the marketing of the instrument itself.

In the planning phase, it was thought best to take the broadest possible view, since improvements are dependent on the behavior of a large number of market participants and will be achieved only after the modification of complex (and often esoteric) processes that match up borrower and lender. For example, the process of exchanging information related to municipal credit is extremely diffuse in terms of data origination and, today, is heavily reliant on the summary opinions of two private credit rating agencies, who themselves have difficulty in getting timely and usable data. Thus a major existing flow of information is the published ratings themselves. However, the lack of available data and the dominance of published ratings have led to what is acknowledged by many to be a lack of development in the area of municipal credit analysis. This is coupled with continuing controversy as to how such analysis should be performed and criticism of the agencies, in particular, for failure to be more explicit in how they grade municipal securities. At the outset, therefore, one is faced with the twin tasks of better serving the existing needs for information and of recognizing that improvements in investor uses of information and its analysis may alter those needs.

It is necessary to acknowledge a tension between the positive (what is) and normative (what should be) aspects of the study:

(1) How can information flows, credit quality and marketability be improved while accepting the current concepts of what constitutes best credit practice and analysis, actual market performance, and various institutional constraints; versus

(2) How might information flows, quality and marketability be improved were the concepts of quality, its analysis, and its bearing on market performance and constraints themselves to be changed.

At the risk of letting everything vary at once, the planning project adopted an initial strategy of proposing studies both to identify existing concepts and practices and to propose research that might modify the existing concepts and perceptions as to what constitutes credit quality, how it might better be measured, and whether or not certain institutional constraints and behavior were optimal in view of such revised concepts and actual experience in the market.

The obvious drawback to this approach is a diffuseness in and competition for attention; but in a planning phase this seems to be more than offset by the advantages of examining a number of candidate techniques and strategies of research, with a minimum of a priori constraint.

The first two reports deal specifically with an examination of the concept of credit quality and how it might best be measured. The particular stress is upon what constitutes and how one might best anticipate payments difficulty on the part of governmental borrowers. The following report proposes research to evaluate the mechanics and contents of the existing credit information network, particularly as it is provided by State or

privately sponsored advisory services. The adequacy of both credit quality concepts and information concepts will depend ultimately upon how well they meet the needs and uses of bond market participants, especially investors. The next two reports, therefore, relate specifically to analyses of how such concepts and information influence investor behavior. The studies proposed carry both positive and normative elements since investor and regulatory perceptions of quality might be subject to modification if more is known about actual performance.

The last two reports deal with a range of governmental and private programs and debt marketing techniques that might enhance the creditworthiness or marketability of State and local obligations. The first report focuses on various credit assistance programs and ways of better designing the debt instrument itself to improve its salability. The second of these dwells on alternative growth and land-use policies as they relate to fiscal capacity and market appraisals of credit quality.

The projects in each major area are next reviewed briefly, followed by a critique and conclusions.

## A. Credit Definition and Measurement

1. SUMMARY OF REPORTS

"CONCEPTUALIZING AND MEASURING GOVERNMENT CREDIT QUALITY"  
(Roy W. Bahl and Michael J. Wasylenko)

Research Statement

There is need to develop an analytical framework to relate explicitly various economic, fiscal, and debt characteristics to the comparative measurement of credit quality. This requires the selection and development of comparative data sets to demonstrate the operation of such a system. A system of credit classification must be developed out of a clear definition of the object being measured. Here, that definition is credit risk as the probability of default. In view of the sparseness of default experience, the set of relationships will depend heavily on conceptual (or theoretical) analysis of the possible behavior of key characteristics in periods of economic or fiscal adversity.

Research Plan

Governmental credit quality is to be systematically related to economic base, fiscal, and debt characteristics. Most data and analysis will involve governmental borrowers in the SMSA's, with certain items to be estimated for cities in excess of 25,000. A variety of data sources are to be used.

## a. Economic Base

The project will describe and measure various dimensions of economic base and the types of instability to which they may be subject at the local level, either due to local or national economic fluctuations. This will depend on economic diversity in particular units and the

sensitivity of components and the aggregate to national or regional changes in economic activity. Interpretation must be geared to dependency and responsiveness of local revenue systems to the base.

b. Fiscal Base

Relative exposure to default depends on a complex of expenditure and revenue characteristics of the borrowers, for which summary measures shall be attempted. Included are projection and comparison of levels of public service demand versus the overall level of economic activity and resources; the adequacy and stability of available revenues under various fiscal systems, including degrees of flexibility in use of revenues and the degree of concentration in the tax base; the importance and trends in intergovernmental revenue assistance; and changes in functional responsibility among levels of government.

c. Debt Factors

Given the economic base and revenue characteristics, relative debt burden depends heavily on forms of measuring debt and a variety of other economic and legal constraints that may alter debt bearing capacity. Relationship of debt burden to possible changes in debt capacity is the final link in measuring exposure to default risk.

Policy Implications

A recurring complaint in municipal credit analysis has been a lack of disclosure of the factors used to judge credit, especially by the rating agencies. The project would demonstrate a rigorous and explicit method of relating measurable characteristics into an empirical-comparative data system. The system, in turn, could lend

itself to a quantitative rating technique using a multidimensional scale or single scale (with assignments of weights to various factors).

"CASH FLOW AS A MEASUREMENT OF RISK"  
(Philip M. Dearborn)

Problem Statement

The ultimate test of credit quality is the degree of likelihood that a borrower will have cash available to pay debt service when due. The key element is immediate cash availability since less liquid remedies can be costly and protracted.

Research Statement

Most financial emergencies can be averted with sound management and adequate cash revenues. However, unexpected external "shocks" to the normal patterns of cash flows can precipitate financial crises. Thus, methods of analyzing payments performance must also consider the ability of governmental units to respond to these unexpected events. This discussion suggests three general fiscal and administrative characteristics that should be evaluated in considering risk of default:

- (1) Immediate cash availability to meet initial crisis period until correctives can be instituted.
- (2) Degree of compulsion on local officials to diagnose and take corrective action.
- (3) Available methods for taking remedial action.

It is suggested that each of these characteristics has gradations in practice that are subject to measurement and its selective importance can be weighted in terms of protection from default.

Under each characteristic several techniques are described and tentatively classified as to their relationship to cash flow adequacy

and perceived risk.

Policy Implications

Models of creditworthiness should incorporate and collect data on these cash-related factors. No final proposal is developed for an empirical investigation of the prevalence and behavior of these factors or for a specific way in which they might be used in a credit rating system. However, the conceptual development lends itself to a surveying of practices that should correlate to degrees of protection against both emergency and protracted deficiencies in debt payments.

2. CRITIQUE

Mr. Bahl's report raised many important issues that have been debated in a less organized fashion. Essentially, it argued for a crisp definition of credit quality to be consistently applied in the development of formal indicators by which quality can be measured. While arguing that the particular choice of factors and weights in achieving a credit rating may be largely a matter of judgment and logic, Bahl underscored the need for a concrete and fully explicit model that all participants could know (if not necessarily agree with) and, presumably, could manipulate and rework to suit their particular needs.

The principal focus of the Bahl endeavor was upon the longer-term aspects of fiscal and economic base interdependence. Mr. Dearborn, on the other hand, narrowed his focus to a central concern of cash availability: the ultimate test of credit quality is the degree of likelihood that a government will have cash available in the future to pay debt service commitments when due. While longer-term structural difficulties may make a government more susceptible to payments difficulty, it was clearly Dearborn's feeling that fiscal management aspects predominate in potential cash shortages. Thus, whatever the borrower's particular economic or

fiscal base, poor timing and mixture of receipts versus cash outlay requirements can cause difficulty; essentially sound governments that are poorly managed can have payments difficulty.

Dearborn's analysis, while not denying the importance of fundamentals in determining the potential for cash difficulties, emphasizes the added dimensions of financial management quality and legal requirements to avert or solve such difficulties.

#### Appropriate Definition

Discussion and correspondence exhibited a mixture of opinion on the appropriate definition of credit quality and the degree of accuracy by which it could be measured. Starting with areas of agreement, consensus did arise that, in terms of credit risk, an essential, if not the central target variable should be cash adequacy to avoid payments shortfalls. At the same time, it was generally felt necessary also to relate cash needs versus availability to the longer-term economic and fiscal base characteristics. Mr. Rubinfeld asked that the short and long-term factors be linked by analysts as two means by which default might occur. Mr. Breen indicated that these factors are distinguished, at least in the Fitch system. Mr. Hempel stated that factors with longer lead times should be used in the forecast of cash adequacy than those given in the Dearborn outline. Nonetheless, practitioners were obviously impressed by the scheme Dearborn had devised.

#### Measurement Problems

Basic disagreements arose over the possibility or desirability of analysts (a) making explicit comparisons among credits, (b) the proper interpretation of various credit measurements, and (c) the formal development of multi-dimensional, quantifiable rating systems. Mr. Breen, for example, argued that such systems of measurement were too inflexible

and that although the letter grades produced by the rating agencies might be used as summary comparative measures of credit quality, that the verbal rationale provided was in fact the heart of appraisal. This hesitancy to embrace formally quantified credit-rating systems was evidently shared by Messrs. Tinsley, Moak, and Steinkamp. Mr. Bahl and Mr. Rubinfeld argued that only by attempting as explicit a measurement as possible could one know on what grounds a specific rating was based. Despite differences on how to measure and weight credit components, it was agreed that better cash flow indicators need to be developed. Messrs. Breen, Moak, and Goss stressed the importance of various income and outlay flow factors as opposed to the traditional stock measures.

#### Cost of Data

George Hempel stressed the difficulty of empirically proving the superiority of models, or their components, in view of the lack of default experience. Much comment was received on the practical as opposed to conceptual problems of definitions and measurement. The cost and availability of data were frequently cited as impediments to implementing more formal quantitative models. It was felt by Mr. Dearborn that efforts to improve credit quality measurement should start with the minimum of information required to indicate potential trouble spots. The point was stressed that costs of data collection -- in view of the absence of agreement beyond certain fundamental factors -- needed to be carefully weighed against possible benefits. An important aspect, too, was the timeliness of such information.

A suggested area of special concern for the credit quality aspects of the project was that of the impacts of inflation on both the fiscal performance of governments and investor preferences (Messrs. Gies and Tinsley).

Other Risks Besides Default

A final issue relating to the definition and measurement of credit risk revolved around the importance of default risk relative to other risks in determining the cost of capital to borrowers and the risk/return calculations of investors. The point was frequently made that default risk may be the risk fundamental to published ratings, but that interest cost differentials are determined by investors, ultimately, who face a larger complex of market risks (Messrs. Tracy, Petersen, Zarin). In this regard, Mr. Solari stressed that ratings play a role beyond that which the agencies envisage for them because the investors do use them as a comparative measure beyond the one dimension of default risk for which the agencies state that they are intended. This added dimension relates to investor perceptions of various other risks and their impact on market behavior. (This is the subject of research discussed below in Section "C").

3. CONCLUSION

The contrast struck in the Bahl and Dearborn papers was most useful in eliciting strong responses from both academics and practitioners, which helped to focus on areas of initial agreement. The emphasis on cash availability to meet debt service in timely fashion (as opposed to more subjective and multi-dimensional targets) evidently vindicated the cash-flow operating hypotheses set forth in the planning proposal. While discussion did suggest inadequacy of certain traditional credit measures, it also lent importance to certain managerial and legal aspects that have been traditional concerns for professional analysts and rating agencies, but that defy quantitative specifications.

On the other hand, the complexities of the area, the lack of agreement on (and development of) analytical techniques, the limitations of data,

and the inability to empirically test competing concepts, all seem to lead to the conclusion that complex and elegant models would not be enthusiastically received. In particular, the farther the proposed analysis moved from the operating "cash-register" of a government's accounts, the greater was the disagreement over relevant factors (and the more likely the charges of being excessively academic). However, economic base and demographic factors are held to be important in conventional analysis because, even with the cash-flow variable as a target for credit quality, the longer term forecasts needed for credit quality estimates require the tracking of basic factors into their impact on the governments' capital needs and cash needs.

Emphasis on research in this area should be toward developing measures of projected cash adequacy and the types of data needed to support such measures. This would suggest case studies of financial management and the host of fiscal factors that influence liquidity in a variety of governments. As a practical matter, the formal development of a summary list of "early-warning" indicators, explicitly built on a cash adequacy framework, might have the greatest impact on present analysis. Research in this area will be of most use if it works toward stressing consensus items among practitioners and, in the process of achieving rigor and consistency, reinforces or erases competing factors from the framework.

## B. Collection and Dissemination of Credit-Related Information

1. SUMMARY OF REPORT

"COLLECTION AND DISSEMINATION OF CREDIT-RELATED INFORMATION"  
(John E. Petersen)

Research Statement

There is a need to evaluate the quantity and quality of information relating to credit quality and financing practices. Such information, along with various collateral services to investors and borrowers, is now collected and disseminated through a variety of private and public mechanisms with greatly varying degrees of comprehensiveness, availability and comparability. The existing information system should be analyzed in terms of its providing data to meet investor needs and/or to achieve improved levels of analysis. Furthermore, the various techniques and components of the current system need to be compared to alternative information systems, including the collection and dissemination of data at the national level.

Research Plan

Research will concentrate initially on a thorough inventory of the present network of information sources, primarily at the State and Federal level, through use of surveys and interview techniques. A survey of State information services is already in progress. The resulting listing of information sources and practices will be analyzed for cost, completeness, comparability and other qualities on a State-by-State basis. In addition, the existence of State requirements for reporting and disclosure purposes and the provision of other debt-related technical services will be collected and compared. This will include an extensive survey and

appraisal of information furnished in debt offerings and post-sale reporting.

In conjunction with other projects, a second phase of research will correlate (1) alternative measures of credit quality and (2) user (investor and borrower) information needs and uses with existing and potentially available data. This should permit evaluation of the feasibility and cost-effectiveness both of current practices or of modified collection and dissemination systems. Also, there will be an analysis of developing legal and regulatory requirements as they bear upon the informational process.

#### Policy Implications

In addition to providing a comprehensive description of existing sources of data, the project, in conjunction with companion studies, will evaluate the relative effectiveness of the various methods of collecting and dissemination of credit-related information and technical assistance. Such evaluation should lead to identification of best practices and standards, and suggest improvements in information systems to meet a variety of needs with greater efficiency.

## 2. CRITIQUE

Comment on the preliminary and proposed study of credit-related information systems was uniformly favorable, as an area in need of research and operational improvement. It was noted through conference opinion and pilot studies that both the contents of various financial reports and documents and the process by which they are collected and disseminated

to the market are both of great importance and in need of substantial improvements. It should be stressed, too, that this project forms a bridge with other areas of study that focus on improved definitions of and measurement of credit quality, better meeting investor needs, and enhancing the methods of marketing state and local securities. The following principle issues and points were raised in communications and conferences:

Disclosure and Investor Protection

Perhaps the most salient theme that did emerge from this discussion was the growing awareness of an increasingly urgent need for substantial improvements in the standards for disclosure practices on new issues. Commissioner John Evans of the Securities and Exchange Commission, and Richard Goss and Robert Doty, highlighted the growing concern by the courts, Federal officials, and others that adequate financial reporting is even more essential in light of proposed regulation and well-publicized examples of fraudulent activity already within the context of existing securities law. As summarized by Philip Dearborn, "MFOA should develop standards and guidelines for disclosure of information before some financial officers get caught in serious lawsuits and before the SEC or other Federal agencies usurp their responsibility". Messrs. Moak and Schimmel, among others, noted that such an effort would provide benefits to all issuers, but would be especially helpful to smaller municipalities, which pay the least heed to sophisticated market requirements.

As noted by James Marling and Michael Zarin, the attainment of substantive improvements in disclosure and reporting practices calls for a careful analysis of the costs of inadequate reporting, as part of the process of education of issuers as to the importance of accurate and

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timely credit information. Mr. Crossman stated that the greatest contribution the proposed project could make to the rating agencies would be to devise ways to improve financial reporting practices.

#### Reporting and Advisory Mechanisms

The focus on reporting practices widened to several considerations of how improvements should be made. In the first instance, some representatives of the investment community suggested that direct credit information was most important at the time of issue and that the burden of monitoring such information on a post-issuance basis would be extremely costly and better left to, say, the rating agencies. Post-issuance credit information is also important, particularly for the rating agencies, but these agencies stressed the great difficulties in collecting such information on a timely basis, either directly or from intermediaries.

Both conference participants and the pilot survey results indicated that, by-and-large, State agencies should provide increased debt-advisory services (including information gathering). Special benefits, again, would accrue to the small issuers who now often receive limited or amateurish advice on the technical aspects of debt marketing.

#### Uniform Reporting

A major block to improved analysis and improved investor information is the variety of reporting formats and accounting systems employed in local governments. Mr. Marling noted the difficulties experienced by the State of Michigan when it adopted a uniform local government accounting system. While it was felt that accomplishing a national uniformity in accounts was visionary, if not impossible, it was stressed

by Mr. Grossman that the project should try to establish some kind of basis of comparison for different State fiscal reporting to serve as a basis for a national reporting system.

#### Limiting Information Needs

Several comments were received on the importance of keeping the information burden and costs to an economically defensible minimum. The mood was, that barring a major and unforeseen novelty in analytical requirements, primary stress should be placed on timely and complete retrieval of that useable minimum of data most closely attuned to the current or immediately foreseeable needs of analysts and investors. Mr. Dearborn, in a communication, stressed the desirability of creating a limited array of cash-focused items that would form the backbone of the credit analysis of individual units. Also noted was the need of obtaining agreement on fundamental data sets from analysts and investors as a practical guide for prescriptions of contents and procedures.

### 3. CONCLUSION

The central focus of the project, to study the process of collection and dissemination of credit-related information (and the agencies and materials involved in that process), is evidently especially pertinent. This stems not only from meeting the traditional needs of investors, but from meeting emerging legal responsibilities in the areas of investor protection. Preliminary survey results indicate a great variation in the adequacy and timeliness of credit-related information provided by issuers. After development of a reasonably complete description of available sources and techniques, analysis should aim at methods of promoting the following:

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standardization of document contents to permit more comparative analysis; determination of the best locus for various types of information, given economic and institutional constraints; guidelines for full disclosure of factors that materially influence investment value; and the development of information items, now absent or ill-defined, that may be needed for more sophisticated analysis.

The above objectives call for a strong user orientation and a multi-disciplinary approach. Improving the comparability of credit data will need the support of those skilled in municipal accounting. Adequately satisfying (and anticipating) various disclosure requirements will demand legal scholarship. The appraisal of information systems will call for expertise in credit analysis and information management and finance. To have an impact, the policy prescriptions need not only be well-documented, but reflective of the various interest groups involved. In the normative phases of assessing adequacy and recommending improvements, this study is heavily dependent upon the research to be performed in the credit measurement and investor needs and uses areas. Furthermore, the project should contain a strong implementation component.

## C. INVESTOR NEEDS AND USES FOR MUNICIPAL CREDIT INFORMATION

1. SUMMARY OF REPORTS

"ASSESSING THE VALUE OF CREDIT INFORMATION"  
(Ronald Forbes)

Research Statement

There has been an increasing concern that a lack of efficient information systems is contributing to imperfections in the municipal market. This study is designed to evaluate the costs and benefits of developing a more effective flow of credit information. The relevant questions that are explored include:

- (1) Is there any perceived "need" for additional sources of credit information?
- (2) What specific costs can be associated with less than "full disclosure"?
- (3) What specific types of credit information are important?
- (4) What is the appropriate delivery system for such credit information?
- (5) What are the operational, technical and economic parameters associated with the development of a municipal credit data base and analysis center?

Research Plan

An important part of the methodology for this research will be to undertake a large-scale survey of major market participants. This survey will elicit attitudinal measures of (1) the relative importance of ratings versus direct credit information; (2) the perceived availability of direct credit data; (3) the relative importance of specific types of credit data; and (4) the relative importance of prospectus information

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vis-a-vis ongoing reports.

The analysis will relate the extent of disclosure of specific credit data to the perceived importance of that data to determine what deficiencies may exist in current reporting practices. It will also be extended to determine whether the extent of disclosure affects the terms of borrowing. Preliminary analysis indicates that ratings and numbers of bids received are related to the amount of information reported in the prospectus for smaller issues.

#### Policy Implications

The results of this research program will be used to develop recommendations on the scope and locus of any needed improvements in the flow of information to the municipal bond market.

#### "EVALUATING THE MARKET PERFORMANCE OF MUNICIPAL BONDS"

(Thomas Gies and Timothy Nantell)

#### Research Statement

Interest rate differentials are established through a complex market process that relates characteristics of issues and issuers to the characteristics of investors. This discussion focuses on market risk-market return characteristics of municipals. It also relates the market performance to the operating conventions and regulatory constraints that affect commercial banks.

Portfolio practices of these institutions appear to place a heavy reliance on ratings as surrogates for risk, with a consequent tendency for bank demand to be segmented by rating grade. This study outlines

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a series of tests designed to determine whether the market performance of municipals justifies the emphasis on agency ratings as determinants of portfolio composition.

#### Research Plan

One methodology that will be used to evaluate the relationships between operating factors and bond selection will be an extensive survey of commercial banks. This survey will be national in scope and will focus on developing an analysis of institutional perceptions of the effects of regulatory constraints relative to the intended purpose of the regulatory agencies. This methodology will be supplemented by several studies of the secondary market behavior of municipals. One specific test will determine whether the variability in holding-period returns is systematically related to rating class. A second study will measure the association between marketability (as measured by spreads in bid-ask prices) and rating class. A third study will test the hypothesis that realized yields for defaulted bonds are significantly understated if holding periods terminate at time of default.

In addition, the study proposes to analyze the relationship between yields on unrated bonds and the underlying economic characteristics of the bond issues. The analysis will measure the rating effect by comparing yields on unrated issues with yields on bonds from comparable issues, with ratings.

#### Policy Implications

The analysis of comparative market performance will have implications for three policy areas:

- (1) Have government regulatory agencies been over-conservative in the risk rate assigned to municipal issues.

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- (2) Does actual risk/return performance, under reasonable assumption, justify existing rate differentials among grades.
- (3) Can ratings help municipal issuers achieve more efficient pricing of their bonds relative to their intrinsic creditworthiness?

## 2. CRITIQUE

The logical relationship posed by the original proposal was that improvements in the credit information system-- either its contents or delivery mechanism -- must ultimately be geared to satisfying the investing public (or their agents) since it is they who set the final terms of borrowing. Moreover, improvements in the creditworthiness and marketability of debt would ultimately be judged by their ability to better meet investor (or their agents) needs. This is so whether or not the definition or methods of measurement of credit were in need of (or capable of) being improved. Thus, while the analysis of investor needs and uses was contemplated as a separate study area, it must be viewed as an integral part of the overall credit project .

The original proposal set forth essentially two paths to better knowing investor needs and behavior vis-a-vis quality information: (1) through use of survey techniques, to elicit directly from investors (and other market participants) their present and desired use of credit information and their opinions as to its impact on their investment behavior and (2) through essentially statistical studies of observed investment behavior of investors and the results of that behavior in terms of realized risk/return experience. The latter approach, as developed in the planning phase, ambitiously envisaged the study of

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credit risk as part of the overall risk/return portfolio decision of investors.

The Forbes proposal relates to the receiving end of the credit-information, and thus is a close companion to the collection and dissemination system study (Petersen) discussed in the preceding section, which approached the question from the standpoint of data origination and distribution mechanisms. As became obvious, the two studies need to be integrated to be properly analyzed and the two projects were, in effect, planned in tandem. At the same time, efficiency dictated that the Forbes and Gies-Nantell projects, both dealing with investor attitudes and behavior and both employing survey techniques, needed to be consistent and integrated in the same survey. This integration, while recognized as necessary for the actual study, was not accomplished on a pilot basis in the planning phase.

#### The Centrality of Investor Needs and Preferences

Comments received on the proposals to study the needs and uses of credit information were enthusiastic about the focus on the investor. In fact, it was repeatedly stressed (as noted in Section "A" above) that the investor has a range of risks to consider beside that involved in default, which in the aggregate may largely outweigh those involved in issuer payments difficulty. Therefore, the practical requirements of credit information and investor needs for it surpassed those involved in the measurement of the probability of default risk. In this context, Mr. Tracy pointed out that, from the standpoint of the investor, the market performance of a bond after issue (perhaps in response to news about financial condition or management) was equally important in determining credit quality as was the probability of ultimate default.

Studies of Portfolio Behavior

While the view was favorable toward a focus on investor needs, several comments were raised regarding the feasibility of the proposed techniques of studying investor behavior. First, Messrs. Tracy and Hempel stated that portfolio practices vary greatly among institutions and that, except for the largest banks, are often not formalized. Second, a myriad of factors such as tax-status, monetary conditions, and issuer- or issuer-related legal and fiscal characteristics will condition bank behavior and need to be taken into account. Third, in terms of any study of information requirements, careful attention must be paid to the cost of supplying more data, since any survey of perceived informational benefits, without recognizing associated cost increases, would be misleading.

Secondary Market Performance

Special problems, acknowledged by the investigators, arose in the contemplated examination of the secondary market, primarily involving the lack of data of actual bond trade prices and ask/bid price quotations. Without such data series, estimates of post-issuance price behavior in a controlled sample would be impossible without very expensive original data collection.

Realized Return and Default Experience

Mr. Hempel, in particular, was sympathetic of deeper study of the ultimate return on defaulted bonds. However, it was the opinion of him and others that prior studies had exhausted the data from present sources. A reworking of these data might be useful but appeared to be of marginal benefit at present.

Impact and Efficacy of Regulating Constraints

Comment tended to shift focus on the two aspects of regulation in the commercial bank area, capital adequacy formulas and the impact of portfolio constraints placed upon investors by regulatory bodies. First of all, in the absence of data on secondary market performance and the ultimate pay-out on defaulted bonds, it would be difficult empirically to support contentions of market (or total) risk versus return. Furthermore, it was noted by Messrs. Kaufman and Buser in their comments that risk to the financial system -- as opposed to risk to an individual investor -- required that insuring agencies adopt a different standard of allowable risk than that permitted to individual investors. Thus, what might be permissible to risk for one unit would not be permissible in the aggregate to the system of units.

3. CONCLUSIONS

While the investor orientation is an important feature of potentially improving both information flows and market acceptance of bonds, there are many difficulties in mounting a major study of investor behavior in this area. The crux of the problem would seem to be the need to originate much market and portfolio data not now available. The absence of secondary market trading data makes a direct empirical estimate of the marketability factor in investment decisions an historic task. By the same token, studies of realized return on defaulted securities, while of potential value, seem also to lack available data. The costs of developing such data sets would be great and requiring of a project on their own. Obviously, without extensive risk/return studies, critiques of the rationality of either regulatory or investor constraints and behavior are, at best, difficult to substantiate.

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Many of these aggregative problems can be avoided by concentration on a direct survey of investors, foregoing the costs (and losing the advantages) of studying objective data on market performance. Such survey work -- which has resulted in some promising preliminary results -- will require careful attention to questionnaire design and procedure. The use of the limited market-wide portfolio and yield data may be employed to validate and extrapolate the survey work.

Proper organization and interpretation of such research does require a formal, testable statement of investor portfolio behavior. This, unfortunately, was beyond the capability of the planning project to develop. While such a necessarily conceptual statement -- in view of the limited opportunities for empirical testing -- lacks "practical" appeal to some, it nevertheless needs to be constructed prior to data gathering or testing.

The study of unrated bonds -- to test certain hypotheses as to the value of the ratings and as an insight into their effect on marketability-- can most effectively be approached by statistical analysis of new issues for which much necessary data are available. Here, a determinant analysis of new issues, reflecting variables posited or found important to investors (as supplied by the information gleaned from a well-done survey document that is focused on credit-related aspects of portfolio behavior), would appear the best approach.

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D. Improving the Credit Quality and Marketability  
of Municipal Obligations

1. SUMMARY OF REPORTS

"ASSESSING POLICIES TO IMPROVE THE QUALITY OF THE  
CREDIT AND THE QUALITY OF THE BOND INSTRUMENT"  
(Ronald Forbes, Arthur Hierl, Edward Renshaw)

Research Statement

Concern over relative borrowing costs has led to a number of innovations in the municipal market. Many of these innovations have focused on devices designed to reduce default risk, such as the use of guarantees, insurance, and state backup provisions. However, there are vast differences in the manner in which each program attempts to improve creditworthiness and there is some casual evidence of significant variations in the cost effectiveness of these programs. To date, there has been no systematic evaluation of the relative effectiveness of the alternative approaches to improve credit quality and the proposed research program is designed to fill the gap. Emphasis will be placed on developing estimates of comparative borrowing costs for insurance and guarantee plans; for policies designed to segment overall municipal debt by risk class; and for specific programs designed to assist school districts.

Another approach to credit assistance has focused on the development of a more efficient bond instrument. To date, most programs have emphasized the inefficiencies of small bond issues and have attempted, through pooling arrangements such as bond banks, to "package" these securities into a more marketable form.

### Research Plan

Four distinct projects will be carried out to evaluate specific types of credit assistance. One project will focus on bond insurance and will analyze the relationships between the costs of insurance and the present value of future benefits that result from guarantees against default.

A second project will develop estimates of the weighted average cost of capital for selected cities and states with a similar overall debt burden but with varying proportions of general obligation debt outstanding. The analysis will focus on the relationship between the cost of capital and the mix of revenue-general obligation financing.

A third project will evaluate the relationship between the amount and form of state school aid and the relative borrowing costs of school districts. The specific tests will be designed to estimate whether revenue assistance has reduced the cost of school borrowing.

Using an extended data base on new municipal issues, a fourth project will estimate the relationships among borrowing costs, the number of bids and underwriting spreads and the size, rating and timing of new issues.

### Policy Implications

In addition to providing an evaluation of the relative efficiency of alternative approaches to credit assistance, the results of these studies will be directed toward the design of new policies. For example, the interrelationships between optimum issue size and credit quality may suggest the viability of new concepts such as the sale of term bonds by communities, with debt retirements managed through a state sinking fund.

"LOCAL GOVERNMENT DEBT AND GROWTH MANAGEMENT"  
(George Peterson)

Research Statement

Growth poses particular problems for debt financing because of irregular, lumpy demands for capital funds, as communities experience cycles in development. Increases in debt in turn translate into (1) increased tax rates and (2) enlarged supply (glut) of bonds. Both erode market acceptance and prices of debt instruments. Additionally, the composition of growth can be such as to cause fiscal imbalances as expenditures outpace tax receipts. Pressure of growth on capital needs and market acceptability of local debt can be mitigated by the following policies:

- (1) Public Facility Ordinances: Local restrictions on pace and place of growth and the capital demands thereby generated.
- (2) Fees and Exactions: Making private sector (developers) absorb costs of development directly (fees and dedications in new developments).
- (3) Fiscal Zoning: Restriction on growth to those activities that "pay their own way".

There is evidence that the market and analysts react favorably to positive controls on growth. This relates to the ability of government to alter (or offset) changes in its underlying characteristics as they reflect upon its fiscal capacity and/or market appraisals of its creditworthiness.

### Research Plan

A large sample of local units will be taken to relate growth patterns to debt loads and market performances and to examine for systematic relationships among growth cycle and debt structure and market behavior. A sub-sample of rapid-growth units will be studied to analyze experiences with alternative growth policies and divisions of cost between public and private entities.

### Policy Implications

This analysis, of the extent to which the growth cycle accounts for differences in local public debt bonds and market acceptance, will suggest alternative policies to affect growth impacts and to improve credit position and lower borrowing costs.

## 2. CRITIQUE

The two reports presented here deal with very different sets of variables under the control of governments that condition the quantity, quality, and types of their indebtedness. The first project by Forbes, et. al., accepts the nature of the debt demand as given, then discusses ways that techniques of credit assistance or bond design and marketing form can be improved to lower the cost of capital.

George Peterson's proposed study focuses on the growth policy related aspects of debt needs, credit quality, and market performance. As such it forms a linkage between a positive analysis of the forces of growth and development that generate capital needs - frequently taken as exogenous or environmental factors - and a normative study of how these forces can be conditioned or modified through policy options to achieve more predictable and relatively less expensive debt burdens. The product of both projects should be a series of documented suggestions on how communities can improve

their credit quality or debt market performance.

Emphasis on Growth

Most comments on Peterson's paper revolved around the relative need to study growth-related questions of debt management (in contrast to those of stable or declining borrowers). Mr. Moak, for example, felt that growth issues were of declining importance and not those that were giving the most difficulty to public units. Also noted was the need to relate such analysis into those projects that focus directly on quality models and to recognize private-sector burdens (Mr. Rubinfeld).

Analysis of Costs and Benefits of Credit Assistance Programs

Mr. Kaufman in his comments stressed the need for studies of insurance and guarantee programs to analyze the full costs of such programs. With respect to the guarantor or insurer, there should be consideration of the erosion of its credit quality and its credit costs. An attempt must be made to calculate the appropriate premium, as well, in relationship to assumed default probabilities under various economic conditions, an admittedly difficult but essential exercise. Without this, it is impossible to talk of the relative savings and efficiencies involved.

Assignments of State Revenues and Debt Mix

Several participants expressed their belief that State earmarking of funds as developed in the proposal represented an important area of study (Messrs. Kaufman, Moak, and Grossman). However, of the few comments on optimum mixes of revenue and general obligation debt, Mr. Kaufman stated that under normal assumptions it was difficult to see how deliberate shifts into revenue bonds could be of cost advantage to issuers.

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Size and Timing Improvements in Marketability

That part of the proposal dealing with changes in the bond instrument and its marketing aroused considerable discussion. Mr. Kaufman found that information on issue size was inconclusive and suggested refined study of the effects of issue size for small issuers, in particular. He also noted with approval the contemplated research on size of maturities within an issue. Messrs. Moak and Dearborn, in comment and communication, underscored the desirability of research into the term bond structure, both from the aspects of improved marketability and greater financial flexibility for issuers. Mr. Moak also spoke of the need for estimates of the actual cost/benefits involved in callable bonds.

Changes and Problems in the Market

Both written and oral comment reflected great concern over the erosion of overall municipal market quality and absorption of limited tax-exempt funds as reflected in the issuance of pollution control, industrial revenue, certain transportation, and advanced refunding bonds. Mr. Konstas felt that alternative taxable market instruments should be studied to help relieve the problem. In much the same vein, Messrs. Hempel and Fish urged that specific study be made of changing investor patterns and the impacts these might have on future borrowing costs. Mr. Fish, in particular, stressed the need in any general research of debt performance to allow for shifting market-place conditions.

3. CONCLUSION

Forms of credit assistance - ranging from guarantees through shifting of functional responsibilities among governmental entities - are increasing in number and complexity and present an assortment of often practical alternatives to borrowers. The linkage to improved analysis of credit, as

well as a research objective in itself, was repeatedly stressed. A prime example is the importance of earmarked State revenues. While a stronger integration of these programs into an analytical framework is needed, the preliminary work demonstrates that on both conceptual and empirical grounds, the costs and benefits are estimable and of great significance to all market participants. Surveys of investor behavior can be used to gain insight into observed performance and primary market data can be used to achieve quantification of the sundry techniques.

Studies of instrument design (as opposed to changes in the credit character) possess strong possibilities for improved matching of investor needs by borrowers and a clarification of the costs of certain features. Again, the backbone appears to be in the use of available primary market data in determinant analysis (to properly isolate a host of modifying factors), supplemented by survey and interview work aimed at major investor groups (and their agents). A time series study of bond sale timing factors, while in need of more specific development as a proposal, also holds promise for influencing policy and behavior.

While growth-related aspects are only part of the overall capital financing question, they do represent a traditionally important source of demand for credit and possess special problems because infrastructure expenditures frequently precede the wealth and activity that will repay the debt. Moreover, the current focus on land-use and controlled growth introduces a special and immediate need to develop the capital-related aspects of such policies. Last, the policy options to be investigated, while they may provide insight into what should be determinants of credit quality, are basically directed toward a positive analysis of the reactions of the credit market to the growth phenomenon and how it is financed.

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Thus, this study should focus on how a community can improve its creditworthiness and market acceptance by changes in its basic demands for capital and the division of capital costs between various private and public entities. As such, it represents a natural compliment to the study of how a government may better finance debt that it elects to place within its sphere and the immediate need for which is taken as given.

EVELYN Y. DAVIS,  
New York, N.Y., August 11, 1975.

Statement of Evelyn Y. Davis, editor of Highlights and Lowlights of Annual Meetings at the "Wage Freeze" hearings held by the Mayor of New York City.

Mr. Mayor: My name is Evelyn Y. Davis, and I am editor of Highlights and Lowlights of Annual Meetings. I am known as the nation's leading minority stockholder and am speaking here today as a New York City Bond Holder. I am listed in Who's Who in America!

"I am glad to see that you are instituting a 'wage freeze.' But for how long will it last and how good can it be unless you allow Independent accountants to audit the City's books? And when are you going to take steps to reduce the City's payrolls substantially, to eliminate ineligible from the Welfare rolls and to make students pay for their tuition at City College?"

As a bondholder I did not receive Full Disclosure as to the City's true financial condition at the time of purchase and I do wish to bring to your attention a front-page article in today's New York Times by Tom Goldstein as to comments made by an SEC Commissioner as to inadequate disclosure by the City. You stated that since March the City had been *preparing* a prospectus for bond and note issues. But what about Private Investors who bought their bonds Before March 75? And where is this prospectus now?

And you have said nothing about the private small investors. All you and the MAC Board seem to be concerned about are the Banks and the Unions. But remember, Mr. Mayor the Banks are Not the only creditors of the City of New York. There are thousands of small bondholders. And also you seem to care only about the short term notes that are coming due in a few months. What about those of us, Mr. Mayor, who have bonds with maturities from five to fifteen years? What Assurances do we have that we will receive Our semi-annual interest every six months and repayment in Full of principal upon Maturity?

All you and the MAC Board seem to be interested in is to receive help from the Treasury so you can *pyramid* the debt. You have Not yet done anything to reduce expenditures. So far it has only been talk. A freeze is a good beginning, but it is not enough. I agree with Secretary of the Treasury, Bill Simon, that the City should not receive Any Federal help but ought to reduce its expenditures. And With action, not with words Mr. Mayor and with Independent accountants checking the results. And we cannot bear any higher taxes. . . . I want you to know Mr. Mayor. I voted for you because I thought as a financial man you would be able to straighten things out. Do not let me down now!

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EVELYN Y. DAVIS,  
New York, N.Y., October 3, 1975.

Mr. KENNETH McLEAN,  
Staff Director, The Senate Banking Committee,  
DSOB 5300, Washington, D.C.

DEAR Mr. McLEAN: As per our chat of yesterday I am including my statement to become part of the official and permanent record of The Senate Banking Committee dated October 8, 1975.

I would have preferred to have made this statement *in person* and I do hope that in the future the Committee will have a more balanced hearing including investors. After all it is the investors who are affected Most! And I am surprised to say the least that my Reasonable request for no more than five minutes to read my statement in Person was refused!

EVELYN Y. DAVIS.

Enclosure.

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EVELYN DAVIS,  
New York, N.Y., October 3, 1975.

DEAR SENATOR PROXMIRE: I am writing to you as a New Yorker and a New York bondholder. As to Senator Humphrey's suggestion of creation of a new agency to help out or insure municipalities and their debt obligations, in my opinion this merely will result in throwing good money after bad, and encouraging further poor and wasteful management and expenditures of taxpayers money! If a publicly owned corporation were operated the way the City of New York has, we stockholders would have thrown the management out a long time ago. And I am a New York City and New York State bondholder as well as the bondholder in some other state obligations. This agency would be a further burden on the tax-

payers and the City would then never make the substantial cuts it has to make permanently in order to regain access to the financial markets and to get back its credibility. However, why should innocent people such as Existing bondholders have to suffer. What is possible is to have the Banks take a moratorium on interest payments but to have the private small bondholders temporarily receive their interest from the Treasury (as a loan to the city, but given Directly to the bondholders and *not* the City, because then we bondholders will never see the money but it will be given away again) through perhaps Federal Reserve Bank branches in case of DEFAULT. This would be NO cost to the Treasury because in due time the City would be able to take care of its long term obligations. *And I do feel now that the best solution will be default for the City of New York.* This will clear the air and the financial markets have already to a large degree discounted this possibility! Why now have a new agency and Encourage poor management and fiscal irresponsibility further. Let New York's default be an example for other cities to straighten out their finances. If the City of Detroit can make permanent cuts of 20%, why cannot the City of New York do the same NOW? And the rest of the country, Senator Proxmire including Wisconsin (at least chairmen and presidents of large corporations who are subscribers to this publication, Highlights and Lowlights of Annual Meetings) do Not wish for direct Federal aid to the City of New York. (Upon request I will be glad to submit to you a few names of those subscribers who have given me their permission to be quoted; the great majority have not given me this permission on account of their New York Banking connections). They feel as I do that only a temporary sell-off in the bondmarket and the stockmarket will occur, with short term higher interest, but nothing "catastrophic" as some New York politicians have stated. And these gentlemen ought to know they are our business leaders! And what is needed is new legislation to protect municipal bondholders the same way as stockholders are now protected by the SEC, and as the nation's leading minority stockholder I ought to know. My name is known to most of our over 30 million investors! But to insure *New* municipal bonds is Not the answer, but disclosure laws with independent accountants checking the cities' books is the solution! *Existing* bondholders should be protected with the plan I outlined above, and NO new agency should be established. By the same token aid to Companies such as the *Penn Central* and *Lockheed* should be discontinued and perhaps the Federal Loan Guarantee Board should be abolished altogether! *Lockheed* can be merged into another Company, and the same goes for *Penn Central*.

Sincerely,

EVELYN Y. DAVIS,  
*Editor, Highlights and Lowlights.*

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U.S. LABOR PARTY,  
*Washington, D.C., October 14, 1975.*

HON. WILLIAM PROXMIRE,

*Chairman, Senate Banking, Housing and Urban Affairs Committee, Dirksen Senate Office Building, Washington, D.C.*

MR. CHAIRMAN, MEMBERS OF THE COMMITTEE: The U.S. Labor Party would like to submit to the record material on the New York City financial crisis, that we believe has not received adequate attention in your hearings.

The starting point of the U.S. Labor Party is the right (and the absolute necessity) of the working class to have the level of services and living conditions required by an advanced industrialized society with pressing needs for skilled and highly educated labor. Therefore any proposal to solve the New York City crisis that does not accept that as its first premise is unworthy of consideration. Along this line we submit to the record the U.S. Labor Party proposed "Bill of Rights for Labor".

We also submit portions of the U.S. Labor Party presidential platform, "a new kind of leadership for the United States," which provides the precise measures that can be taken to solve the financial crisis of New York City—starting with an orderly process of debt moratorium and the creation of the new credit issuing institutions to maintain and expand essential services, and on a broader level, production and international trade.

Sincerely,

U.S. LABOR PARTY.

MARSHALL, KATES & ROSEN,  
ATTORNEYS AT LAW,  
Los Angeles, Calif., October 17, 1975.

Re City Aid Bill—Rent Control.  
Senator WILLIAM PROXMIRE,  
Senate Office Building,  
Washington, D.C.

DEAR SENATOR PROXMIRE: It is becoming increasingly apparent to myself and other citizens of this country that New York is probably going to receive some sort of financial aid. I am sure that you are more acutely aware of the problems than I will ever be, both political and financial. The question that I would like to present is the fact that most of New York's problems were caused by rent control.

This is not to say that the unions and over-zealous spending have not contributed to the problem, but the clear fact remains that had New York City not have enacted rent control in 1943 as an emergency ordinance or had terminated it within a year or so after the end of the war, they would not find themselves in their present financial predicament today and the crisis may have gone or would have been at least deferred for three to five years. Let it be clear that rent control affected New York City as follows:

(1) A substantial reduction of the tax base as a result of abandoned housing, dilapidated housing, and a lack of appreciation of apartment structures. As I understand, New York has an approximate 60% tenant population. A great deal of the wealth of a community lies in its housing stock. As the enclosed articles indicate, they destroyed that housing stock.

(2) By holding rents to an artificially low level on rent-controlled buildings, lower income and welfare recipients were attracted to the city and required more city services including hospitalization, police, fire, schools, welfare.

(3) The middle class population of New York was forced to exodus for several reasons. Because of the large number of welfare and low income residents, middle class families found conditions in the city unacceptable and newer buildings which were not rent-controlled or under a modified rent control were so expensive they could not afford to remain in the city. The older buildings which normally would house the middle class population were so undesirable that the bulk of the middle class, particularly those with children, found it necessary to exodus New York. Along with them went the major portion of the city's tax base.

(4) Rent control brought along an ultimate refusal of lenders to lend on these properties and landlords to refurbish and properly maintain these buildings.

It is absolutely critical that if a city aid bill is passed that a prohibition on rent control either in New York or the entire country preferably be attached to it. Every city that has rent control is being destroyed. Washington, D.C. is a clear example of this. Boston, where the mayor is politically helpless as a result of the majority of tenant constituents. In Philadelphia, rent control was barely defeated by a seven to six vote on the city council. It is just a short time until that city council because of the changing constituents will pass a rent control bill.

It has been my observation that the administration, including Carla Hills, has been totally remiss in attacking this problem. The only action HUD has taken is to exempt their own projects which were being destroyed by local rent control. The city of Boston, of course, decided to sue HUD on this matter since, politically, Kevin White had no choice.

It is absolutely clear to me that the concept of state's rights or home rule has no application when it becomes the federal government's responsibility to salvage municipal governments. Rent control will only exist in those municipalities that have a majority of tenants and it is those very municipalities that will be clamoring for city aid.

I sincerely hope that this problem coupled with the fact that virtually no apartment construction is currently being done because of rent control, or the threat of rent control coupled with insufficient capital return will prompt you to be a leader in this problem. Most congressmen have simply taken a neutral view on one of the most important issues in our country. The issue is clear. Should we permit rent control to destroy our metropolitan centers?

I hope to hear from you soon.

Sincerely,

LAWRENCE KATES.

[From Barron's, Apr. 21, 1975]

## DISASTER AREA, "RENT CONTROL" HAS HELPED TURN GOTHAM INTO ONE

(By James Grant)

The fiscal plight of New York City, a serialized drama of uncertain length (and which may or may not have a happy ending), has gained national notoriety in recent weeks. Early this month, Standard & Poor's Corp. suspended the city's credit rating. Only the timely arrival of state aid—some \$400 million which Albany itself had to borrow—saved Gotham from an imminent, and perhaps disastrous, trip to the credit market. Late last week, City Hall proposed a 1975-76 budget of \$13 billion, including a projected deficit of about \$880 million.

One aspect of the continuing financial crisis, however, has been largely ignored: the steady decline of New York's pre-war apartment buildings. Abandonment of old but still sound structures (to illustrate, the Brooklyn apartment house shown below) is sharply on the rise. Tax arrearages are mounting. Many pre-war buildings happen to be rent-controlled, a state of affairs which, landlords say, makes it impossible to keep them in good repair.

## APOCALYPSE AHEAD?

"Is N.Y. Housing Doomed?" asks the Real Estate Weekly on its April 3 front page. Doomed? One senses hyperbole; apocalypse, after all, is an idea perhaps too much in vogue. Yet the same question is posed, on the same front page, by none other than Roger Starr, New York City's Housing and Development Administrator. "What is our potential for housing 'disaster'?" Starr asks. "Why can one suggest that our housing stock may be reaching a point of no return?" Tax arrearages, abandonment and mortgage defaults worsen apace, he writes.

Starr places most of the blame on the soaring price of fuel. He warns that more deterioration looms unless the City Council passes along part of the higher oil costs to tenants—landlords to date have borne virtually the whole burden.

Fuel, indeed, has risen by 200% in the past 18 months; the cost of labor is up 40% in three years. Taxes alone are expected to increase 10% next year. Yet rents—controlled in some instances, since 1943; successively "stabilized," "decontrolled," and "restabilized" in the years since 1969—have lagged behind. Estimates vary as to just how far.

The gap, without doubt, is widest in rent-controlled buildings, those apartments—about 700,000 remain—built before 1947. Though in one way or another virtually all city apartments are "controlled," the older stock is regulated most severely. Landlords and the city agree that rent-controlled tenants do not pay enough to maintain their own buildings. Citing a seven-year-old study by the Rand Corp., owners claim that the shortfall amounts to \$750 million a year—in effect, a tax on the bricks and mortar of older, rent-controlled apartment houses. The city declines to guess.

Most eloquent evidence that something is wrong is the spreading blight of abandonment. Last year, Starr has testified, landlords and tenants walked away from 36,000 apartments, enough to house the population (at two to a unit) of Sioux Falls, S.D. Starr bases his appraisal on a running count of vacant buildings kept by the Fire Department. Other estimates, pointing up the dearth of hard information, tangle from 15,000 to 50,000 units.

## LAST EXIT TO BROOKLYN

Whatever the numbers, the spectacle of abandonment is haunting: in the Brownsville area of Brooklyn, block after block of vacant apartment houses, stripped of everything salable, stand rotting; 16-inch walls and hardwood floors, ornamental plaster-work and broken glass—deserted. To build an apartment in New York today costs about \$50,000; restoration of an existing unit, depending on its condition, can vary from \$15,000 to \$30,000.

Last month, Judge Bernard Klieger of the Brooklyn Civil Court agreed to view abandonment and decay first-hand in connection with an unusual trial. The inspection was to have included the Bronx and Manhattan as well as Brooklyn, but in Brownsville, three hours after he began, the judge threw up his hands. "I'm so depressed," he said. "I don't want to see anything more." He likened the destruction to Aachen, Germany, in the closing months of World War II.

The trial began in December, when the Housing and Development Administration took a landlord's organization to court to block a symbolic, one-day boiler shutdown. The landlords, about 1,000 strong, had planned the action to protest municipal regulations of fuel pricing. It followed similar "Boiler Conservation Days" last fall.

#### RESTRAINING ORDER

The city sought (and won) a temporary restraining order against the owners on December 5. However, Community Housing Improvement Program (CHIP), the landlords' group, filed a countersuit for \$750 million, a sum which, if awarded, would cause the most sudden austerity wave in the history of municipal finance. (Such an award is considered unlikely.)

The countersuit called for something more immediate—a wholesale, and possibly impolitic, review of the city's housing policies. Indeed, by the last day of the hearings, Roy Cohn—he of *Army v. McCarthy*, and *Fifth Avenue Coach Lines v. New York*—asked that the judge rule rent control unconstitutional, a breach of the guarantee that private property not be taken for public use without fair and adequate compensation.

HDA protested that the court lacked jurisdiction in a matter so sweeping. The setting was indeed improbable—a civil court judge in Brooklyn hearing arguments on the legal theory of rent administration. But Judge Klieger's jurisdiction was upheld in the State Supreme Court and the trial went forward. The hearings, which lasted six days, were concluded on March 19.

Judge Klieger only now is receiving final briefs; his decision is weeks away. Already apparent, however, is the toll that property abandonment and falling real-estate income have taken on the city's finances. Cumulative tax arrears reached \$648.5 million on January 31, up from \$522.3 million on the same date in 1974 and \$494.3 million on January 31, 1973.

#### TAX ARREARAGES

Last year's increase in tax arrearages (that is, the increase between February 1, 1974 and January 1, 1975), plus the 1974 cancellation of real estate taxes, totaled \$226.4 million. Arrearages plus cancellations in 1973 came to \$101.1 million, lower by half. (A cancelled tax is one that the city has either remitted or given up on.)

Most property owners, of course, pay their taxes; a fine of 1% a month is levied on uncollected balances and three year's non-payment is grounds for foreclosure. The city expects all but 6% of the \$2.896 billion it has budgeted for real-estate taxes this year (about a quarter of New York revenues) to be collected by June 30.

That is the bright side. Less appealing are these facts: a 6% delinquency rate, up from 5.59% a year ago, would be the worst in at least 40 years; non-payment by apartment houses, which provide 31% of the city's real-estate tax income, is running substantially higher. On June 30 last year, 21.8% of New York apartment house parcels had slipped into arrears, vs. 11.5% of all real-estate parcels. (Not all parcels, of course, are taxed equally.) "Among the older, walk-up stock," Starr writes, "tax delinquencies went as high as 33% in Manhattan—and even the newer elevator buildings posted double-digit arrears in the Bronx (16%) and Manhattan and Brooklyn (11% for both)."

The city loses in other ways. Not only are delinquencies mounting, but also rent control reduces the taxes that might otherwise have been paid in a free market. Whatever the "rent gap" may be in controlled buildings—\$500 million, \$750 million or \$1 billion annually—New York loses some of it in taxes. Property taxes, of course, are not tied directly to rents, but a property's assessed value to a great degree reflects the income which it produces. If a "gross rent multiplier" of three is applied to \$750 million, for example, the "assessed value" comes to \$2.25 billion. At the present tax rate, the real-estate levy on such a sum amounts to \$165 million. Though the numbers are rough, the theory is sound: less income means lower real-estate taxes. If rents are depressed by law, so are taxes.

#### BAD LIGHT

Obviously, none of this casts the city's tax anticipation notes in a flattering light. (On April 8, there were \$1.1 billion in notes outstanding, issued against future real-estate levies, but backed by the city's general revenues.) A building, though abandoned or in arrears, is normally carried on the city tax rolls until

foreclosure. There arises the question of how much revenue the city may prudently anticipate. The answer, simply, is that no one knows; the numbers—on abandonment, disinvestment, the “rent gap”—do not exist. Without question, though, the outlook for apartment houses in New York City is bad and getting worse.

Certainly, things could be better for Marian Catrina, owner of a five-story walk-up on 35-45 Arden Street in upper Manhattan. Over the past 12 months, he says, he has paid \$16,168.13 in real estate taxes. In that time, according to his figures, expenses have outstripped income by more than \$10,000. Some 40% of the families in his building, Catrina adds, are behind in their rents.

Of his 69 apartments, 39 are rent controlled—that is, based on rents that prevailed in 1943. (With allowable increases since 1943 and barring tenant turnover, a rent-controlled apartment that rented for \$60 a month 32 years ago would fetch about \$114 today.) Catrina estimates that his maintenance costs—taxes, oil, wages—come to \$40 a room, \$10 more than rents in controlled units. Monthly income for the other 30 apartments totals about \$45 a room, he says—enough to cover maintenance, but not to finance major improvements.

#### MINOR VIOLATIONS

Bruno De La Rosa, the superintendent, says that the building has improved in the year under Catrina's ownership—ceilings have been fixed, there is new paint in the halls and the courtyard will soon be repaved. Still, the property has been cited for minor building-code violations and there is need for an overhaul: the wiring should be replaced, while the plumbing, Catrina says, “is a mess.”

De La Rosa shows a visitor a vacant apartment, Number 2H. Red wallpaper, recently torn from the walls, lies wadded on the floor. The medicine chest is gone, taken by the former tenant who also is said to owe two months rent. (Tenants have stolen toilet seats, electrical fixtures and refrigerators, Catrina says.) There is a sticker on the inside of apartment 2H; it reads “Have a Nice Day.”

Catrina's building is located in Inwood, a few blocks from The Cloisters. The neighborhood is poor, largely black and Hispanic, but it is not a slum. “It's a fairly decent place,” says an officer at the 34th Precinct; “there aren't too many incidents.”

Catrina, who emigrated from Romania six years ago, is frightened and frustrated. Though he put down \$30,000 for the apartment house—his only such holding in New York—he says he may turn the title back to the bank and walk away. The mortgage is for \$312,000. “I do the work here, the plumbing . . .,” he says. “Still the people are hating you, blaming you. . . . I'm fed up.”

In another part of town, another landlord recites his woes. The building is 2-24 Hinkley Place, a six-story, seemingly prosperous brick elevator apartment house in residential Brooklyn. The landlord is Sandy Sirulnik, president of Ditmas Management Corp. Sirulnik, whose family has owned New York real estate for three generations, stands on the sidewalk in front of the building, answering newsmen's questions. The occasion is Judge Klieger's tour of city housing, and Sirulnik is explaining the mechanics of losing money.

#### CAUGHT IN THE TUNNEL

“The building is violation-free, it's been upgraded for air pollution,” he says. “Sixty-five of the 82 apartments are rent-controlled. All but one apartment is rented.” Sirulnik says he is feeding the building fresh capital every month, and that out-of-pocket expenses have totaled \$20,000 since July 1973. Fuel costs have more than doubled—from \$7,357 in the fiscal year ended July 31, 1973, to \$19,997 for the 12 months ended July 1974. There have been increases in taxes and salaries and maintenance. Rents have risen as well in the last year—from \$112,029 to an indicated \$121,034 at present—but not enough to keep pace.

“We'll wind up basically in the same situation as last year,” Sirulnik says. “I feel the only way to go is to see the first mortgagee—to seek suspension of amortization payments on the first mortgage. If the bank doesn't go along we'll give them the first mortgage. If there were a light at the end of the tunnel, things would be different. But the tunnel's blocked up with cinder block and I don't want to be caught inside. I don't want to throw good money after bad.”

## EQUITY HAS DISAPPEARED

Ditmas owns 4,200 apartments in New York and substantial commercial properties outside the city. The Hinkley Place apartments, built in 1929, have made money regularly since the family acquired them in 1950. In 1972, Sirulnik guesses, the building might have sold for \$500,000. "Now, I doubt I could get what the mortgage is worth—\$260,000." His equity—\$240,000—has disappeared. How long will he hold on? That depends on what happens in Albany and City Hall, Sirulnik says.

According to Sirulnik, his family has never walked away from a building. Aaron Ziegelman cannot make the same claim, and last month he sat in Judge Klieger's courtroom to explain why. Over the past 12 months, Ziegelman testified, he "abandoned" 15 apartment buildings—gave up the properties at distress prices or allowed mortgages to foreclose. He told the court he is losing money on 67 of his remaining 70 buildings, all of them in solid, middle-class neighborhoods.

"I'll tell you how this process takes place," he began. "You know, a building just doesn't become abandoned, abandonment where it's a shell. I own a building where I have no future in it and I see no future. See, the worst part is not only losing money, it's the lack of expectation.

"I'm in a position where because I do a lot of business out of New York City, I have the capital, the financial ability to keep a building even though it loses money, if I have expectation. But if I have no expectation, I'd be a damn fool to hold on to it. I could sell it to someone with very low cash just to get out and take as much as I can and salvage as much of my investment. And there the process of deterioration starts, because the building now goes from strong hands like ours—and I consider ours good, strong management, financially viable—to weak hands."

## SENSE OF FUTILITY

Are the problems of Catrina, Ziegelman and Sirulnik typical? They are at least representative. Well-managed buildings in desirable neighborhoods can and do make money in New York City. But these, by all accounts, are in a dwindling minority. A sense of futility has come over the industry, something that goes beyond the rise in fuel prices. There is a belief that the City no longer cares, that the needs of property are not merely neglected, but scorned. "Expectation" has all but vanished.

"From all the years I've been in business, I've always heard landlords cry," says Jack Weprin, a housing lawyer. "Now not only are they crying, but they're giving up their properties too."

He adds that with vacancy decontrol, a 1971 law that mandated the gradual freeing of controlled rents, "you felt a resurgence of hope. . . . People who had gotten out of the New York market were coming back in. They felt they could operate and make money."

## BACKLOGS OF YEARS

But the reform was scrapped with the 1974 Emergency Tenant Protection Act. A city plan of "maximum base rents," designed to secure a fair return for the owners of controlled buildings, has been indifferently administered, the city concedes. Landlords say that backlogs, notably for "hardship" cases, sometimes can be measured in years. Delays in getting out the 1974 "MBR" increases sharply worsened an already strained cash-flow situation, owners charge.

According to HDA's Starr, moreover, 55% of the city's controlled buildings failed to qualify for last year's rent increases because of maintenance infractions.

The city housing courts, created by the legislature in 1973, play a pivotal role in deciding when and if contested rents shall be paid. Judge Edward Thompson, deputy chief administrative judge in charge of the civil court, concedes that a bias exists in favor of tenants, not merely in housing court, but also "throughout the city. . . . It's normal for a judge to side with tenants," he says. So important is housing to man's well-being that such an "understanding," is normal and just, he declares. Landlords, for their part, say that the system hampers payments and erodes their authority to collect them. If tenants have a right to decent housing, they ask, do owners have a duty to provide it, regardless of costs?

Far simpler than the administrative history of rent control is its economics: costs, which are not controlled, have outpaced rents, which are. For decades New York has sought to provide decent housing at low prices. But in pursuing

this goal, it has slighted an axiom of economic life: government can regulate the price of a commodity, or it can regulate the supply, but it cannot set both at once. The city has seen to it that many New Yorkers pay a very low rent. (For example, some 10% of all controlled tenants pay only 13% of their income for rent, a landlords' group estimates, based on 1970 census data.)

But low prices call forth less investment and less production, whether the commodity is natural gas or apartment houses. And if prices are low enough, the result is disinvestment or abandonment.

On a net basis, New York City is losing about 10,000 apartments a year, HDA estimates. Construction during the 'Seventies has averaged only 20,000 units annually, down from an average of 37,000 in the 'Sixties. (Abandonment, in large part, accounts for the net decline.) Significantly, privately-financed housing has fallen both in absolute terms through 1972 (the year of the latest available figures) and as a proportion of overall construction. The result, the city reports, is "a critical and growing housing shortage."

#### FORBIDDING RULES

HUD's intercession is the latest change in the tortured evolution of New York housing law. So forbidding, so byzantine are the rules that govern the operation of a New York apartment house that few landlords can begin to understand them. James M. Peck, cocounsel for CHIP, cites the example of 2146 Barnes Avenue in the Bronx. Apartments in the building, he writes, fall under both rent control and rent stabilization.

"Further," he goes on, "there are units in the building which are exempt from either law. Two separate hardship provisions govern the tenancy of this building and there are two separate and distinct procedures for obtaining capital improvement increases."

There is more. "In the building there are rent-controlled tenants, rent stabilized tenants, tenants who were decontrolled by virtue of vacancy decontrol, tenants who are recontrolled by virtue of the Emergency Tenant Protection Act of 1974 and tenants who were restabilized by virtue of the Emergency Tenant Protection Act of 1974. "The situation," he concluded, "if not tragic, would be laughable."

That capital flees uncertainty is amply illustrated by Metropolitan Life Insurance Co., builders of the massive Peter Cooper and Stuyvesant Town developments on Manhattan's Lower East Side. The Met says it has not invested in New York City housing since 1971. "You can't rely on income if everytime you build something they slap a rent control on it," says William F. Leahy, vice president for real estate financing. "You can't control what you sell for and not control what you buy for without disaster."

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[From a New York newspaper]

#### TOURING THE BRONX WHERE NOBODY LIVES

(By Joseph Kahn)

There are entire neighborhoods in The Bronx consisting largely of empty buildings and resembling bombed-out villages.

Many of the buildings—once the homes of middle-class families—are structurally sound but have been ravaged by neglect and vandalism.

The landlords in most cases have walked away from the buildings. They claim operating costs and taxes are too high and rents too low to allow a profit.

An inspection of such buildings yesterday with Ruben Klein, a Bronx realtor, as guide, was a preview of a tour today to show the extent of abandonment throughout the city arranged by the Community House Improvement Program (CHIP), a landlords' organization. One of the participants will be Civil Court Judge Bernard Klieger.

#### \$750 MILLION LAWSUIT

The judge has been conducting hearings into the city's housing problems, an outgrowth of a \$750 million suit brought by CHIP against the city for the loss of revenue.

The auto trip with Klein began in the East Bronx. Along Willis Avenue and Southern Boulevard the realtor pointed to rows of boarded-up buildings with windows smashed out and doors missing.

"The Fire Dept. says that 35 per cent of the cost of fighting fires is the result of fires in abandoned buildings," Klein said. "In the last 10 years 50,000 buildings have been abandoned, according to the department's records."

At Southern Boulevard and 149th Street, Klein pointed to the backs of buildings with black patches—where windows used to be—silhouetted against the sky.

"They're all gone," he said. "And everything you see around them are on the way. This used to be essentially a middle-class Jewish neighborhood, but it has all changed."

Klein drove in and out of blocks of solid abandonment along Intervale Avenue, Southern Boulevard, White Plains Road and Bryant Avenue.

At Freeman and Boone Streets he stopped at a huge empty project. "This square block once housed 350 families," he said. "It was built in 1928. See anything wrong? It's only deserted. The buildings are good. It's no slum. You can see the tiled bathrooms and the rooms even have parquet floors."

During the ride Klein said some of the buildings were only half abandoned. They were occupied by poor families and drug users, who are squatters paying no rent. "I don't know how they manage," he said, "but they do."

#### BUSY BUT SLIPPING

Stopping at Macombs Road and Featherbed Lane, Klein said the neighborhood there used to be one of the borough's best but was fast going downhill. An empty five-story building faced the nearby Calvary Hospital. At 1650 University Ave., an auto tire was hanging across the entrance of the deserted building.

Along Vyse Avenue, Klein pointed out stretches of vacant elevator apartment houses. And at Boston Road and Southern Boulevard he said that even though it was a busy intersection, with stores and a movie house, and was near transportation, the area was beginning to slide badly.

Near Morris Avenue and 151st Street, a few blocks from The Bronx County Courthouse, Klein indicated several windowless buildings.

"See," he said, "right under the Borough President's office. But nobody cares. Billions of dollars have gone down the drain in the last 10 years. My complaint is that the city makes no effort to meet with the industry or the community about the problem. We should be saving these buildings. There are thousands of people who could be put to work upgrading these properties."

"But there's no planning and no desire to plan."

[From New York magazine, Apr. 14, 1975]

#### THE BOTTOM LINE—THE LANDLORDS' TAX REVOLT

EVEN HELMSLEY IS IN ARREARS

(By Dan Dorfman)

Most reasonable people would agree that residential housing in this city is in rough shape. But I had no idea just how rough until last week when Harry Helmsley, one of the city's biggest and most influential landlords, told me that he had stopped paying real-estate taxes on about 190 residential buildings managed by Helmsley-Spear, Inc.

These tax defaults cover almost half of the 400 residential buildings operated by Helmsley-Spear, which the 66-year-old Helmsley heads as president. The firm also manages another 100 commercial buildings in the city, including the Empire State Building. These 500 buildings pay the city annual taxes of about \$26.5 million and Helmsley has a personal stake in every one of them, including the Empire State Building.

In a 90-minute conversation at his modest office at 60 East 42nd Street, Helmsley told me that he, along with the other owners of the 190 buildings, had not paid about \$1 million in quarterly real-estate taxes that came due January 31, 1975.

"We stopped paying taxes because the properties just had no money," Helmsley said. "Sure, I'm aware of the penalty [a fine of 1 per cent a month on unpaid taxes]. But what can we do? The cupboard is bare. The fuel costs, up 200 percent in the last year, are just strangling us."

There's an even stiffer penalty that Helmsley faces: confiscation of the buildings by the city. But that's a way off yet. After a landlord fails to pay his real-estate taxes for three years, the city has the option of taking over the building. At the moment, at least, Helmsley didn't seem overly concerned with such a prospect.

One of the major properties on which Helmsley isn't paying any taxes is the Fresh Meadows development in Queens. Built in 1948, this 140-building complex contains 3,287 apartments that house about 8,800 people. It is a rare thing in the city—a sensible, sensitive, low-density masterpiece of urban design. Even Lewis Mumford likes it. "It got in trouble about a year ago," Helmsley said. "Fuel and electricity costs skyrocketed in a relatively short time and we started to run into very heavy deficits. Losses of \$500,000 a year in recent years suddenly turned into a cash deficit of \$1.8-million in fiscal 1974 [ended last June 30] and the owners paid that \$1.8 million out of their own pockets to cover the taxes and mortgage payments. But there's just no way you can continue to do that."

Helmsley predicted that such arrears were headed higher. The \$1-million delinquency in Helmsley-Spear-related properties in the last quarter, he guessed, would rise about 50 per cent, to \$1.5 million, on April 30.

"About 80 per cent of Helmsley-Spear's residential buildings are running in the red," Helmsley said, "and we just can't keep up with that damn excess in fuel costs." Since he's convinced that most real-estate owners are in the same boat, he expects the ranks of the nontaxpayers in residential housing to grow rapidly—and soon.

Helmsley clearly wasn't kidding. The day after we met, he led a real-estate group into court and filed a \$145-million lawsuit against eleven major oil companies, charging them with fixing artificially high fuel prices from 1968 on.

The latest, but still unpublished figures on delinquencies in real-estate taxes support Helmsley's forecast. A city official told me that the delinquency rate had shot up to a current level of around 7.5 per cent from a 5.59 per cent rate at the end of fiscal 1974. That 5.59 per cent showing meant that the city failed to collect \$148.6 million in real-estate taxes last year. In fiscal 1973, the delinquency figure was 4.94 per cent.

This trend has onerous implications for the city. Real estate is the city's single largest income-producer, providing 25 cents out of every dollar the city raises. In the current fiscal year, the city is counting on real-estate taxes alone to provide it with \$2.9 billion in revenue. Real estate is the prime asset underlying the city's credit, and, therefore, any significant rise in the rate of default on real-estate taxes could seriously impede the city's ability to float new bonds. (Last week one bond rating firm, Standard & Poor's withdrew its "A" rating of city bonds.)

Helmsley is incredibly gloomy. "Residential housing is a disaster area, and it's going to get worse," he said. "Under the city's present policies, residential housing must collapse."

Helmsley foresees an accelerating rate of foreclosures, abandonments, and no new residential housing in New York City. Apartments are being abandoned at the rate of 50,000 a year, up from 30,000 a year ago. And Helmsley sees the figure doubling in the next year or two.

About the only bit of sunshine Helmsley could inject was the hope that, somehow, the city's rent-payers might awaken to the fact that they'll just have to pay higher rents "to stop the mushrooming trend of housing deterioration." He thought an immediate 15 per cent rise in controlled rents would be an important first step to that end. But, said Helmsley remorsefully, "I just don't see it happening. The votes are with the tenants, not the landlords. I just don't think that anybody cares about the deterioration in this city."

How, then, are real-estate owners going to stay afloat?

In large measure, Helmsley explained, through the "cooperation" of the mortgagee—namely the banks and insurance companies. In brief, this means waiving mortgage repayments and even making temporary or permanent reductions in interest. Helmsley thinks they have little or no choice in the matter. "They don't want to take over and run the buildings themselves," he says, "because they just don't have the professional expertise. So they're cooperating."

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[From the Wall Street Journal, June 13, 1975]  
 REVIEW & OUTLOOK—ARTIFICIAL RESPIRATION

"We saved the banks, but we didn't save the city," said Manhattan Borough President Percy Sutton of "Big Mac," the latest artificial respiration of New York City's credit rating. As unlikely as it may seem, our assessment substantially agrees with Mr. Sutton's. The conversion of \$3 billion in city short-term

debt into what amounts to \$3 billion of state moral obligation bonds allows the city to redeem its maturing notes, to the profit not precisely of the banks, but of those of their customers who speculated by buying the bonds at prices depressed by the threat of default.

Saving the city, on the other hand, depends on what Mr. Sutton and his colleagues do with the three months of breathing time Big Mac gives them. The new agency will meet the city's deficit during July, August and September. Come October, it must go back into the credit markets to borrow some \$4 billion in short-term money that it will need for the balance of the fiscal year. Whether it can sell any such amount of bonds depends on whether over the summer the city can restore its basic solvency.

Gazing on Mr. Sutton, Mayor Beame and the rest, it seems to us unlikely. We doubt first of all that they can come up with an honestly balanced budget. Beyond that, even more importantly, restoring solvency depends on a step that seems to be literally unmentionable in the city. Certainly no politician would air it prominently. If memory serves, it was not raised in the otherwise hard-headed series of editorials in *The New York Times*. Most significantly of all, it has not been drummed into public consciousness by David Rockefeller, Walter Wriston and the rest of the banking community, which certainly must privately understand the realities involved.

This unmentionable step is to do away with the city's rent-control system, which at the moment is systematically destroying a goodly part of the city's real estate tax base. In short: Since the real estate tax is the city's basic tax, the creditworthiness of its bonds depends crucially on the value of the real estate it has to tax. Some 31% of the assessed valuation of New York City real estate consists of apartment buildings, the bulk of which are subject to various degrees of rent control. The rent control has not allowed owners to recoup the increase in fuel cost, thus forcing many of these properties to operate at a loss. Ultimately the market value of apartments operating at a loss, and thus their contribution to the tax base, is zero.

In the face of the clear implications, the official figures show a steady increase in the tax base, or full property valuation, of New York City. If you inquire how this can be possible, you find in essence that the city figures its tax base in the same way it has long figured its budget. The full valuation is the assessed valuation divided by a magic number called an "equalization rate." The magic number had declined from 68% in 1964-65 to 48% in 1974-75. Each decline means a theoretical increase in the tax base.

Now, some equalization rate is truly a necessity, and is honestly calculated by a state board. Its basic use is to apportion state aid to municipalities. The board takes periodic surveys comparing market values with assessed values in different municipalities, thus basing the state aid on comparable full market values. The latest basic rate is based on surveys in 1973 and 1970. For New York City this rate is 55%.

Now comes the gimmickry. The city's debt limit is 10% of full valuation. The necessary delays in establishing the basic equalization rate means that debt-limit computations based on it trails actual movements in market values. In times of rising real estate prices, this means the city's debt limit has been understated; thus it has won itself a "special rate" for computing its debt ceiling. This special rate is based on the projection of the "trend" disclosed by the most recent surveys, plus some small amount of additional information. Thus if you are willing to believe that the trend in real estate prices between the 1970 survey and the 1973 one continues into 1975, you get a special equalization rate of 48%. This allows you to compute the full valuation at \$82.5 billion, an increase from \$79 billion in the previous year.

In October of 1973 there was a war in the Middle East. A cartel tripled the price of oil, hence of electricity, hence of a highly important part of real estate operating expenses. This act overnight reduced the market value of all real estate operated for income; the market value of such real estate is nothing but the present discounted value of the future profits. In a free market, of course, this reduction in value would be slight, for sooner or later the owners would be able to increase rents enough to restore the original rate of return.

But in New York City, there is a law against raising rents, at least to the extent energy prices would dictate. Anthony Downs' Real Estate Research Corporation did a study of a sample of good-quality income properties, and concluded that the decline in their market value during 1974 was between 22% and 31% for fully rent controlled buildings and 8% to 18% for "rent-stabilized" ones. It predicted smaller profits and further declines in market value in the future, and added "the combination of falling market values and lack of mortgage financing has made it extremely difficult to sell rental properties in many parts of the city at any price."

Abandonment of housing units by landlords was estimated at 35,000 to 50,000 dwellings units during 1974, the equivalent of net additions for the five preceding years. Landlords have been winning tax assessment reductions in court. In the first quarter of the current fiscal year, 25% of all taxable apartment buildings in the city failed to pay their real estate taxes. Real estate tax delinquencies for fiscal 1974-75 are estimated at \$220 million, up from \$148 million and \$122 million in the two preceding years. The city carries the delinquencies on its books as an asset, and thus \$220 million in delinquencies can be used to authorize \$553 million in long-term debt.

Now, one should not exaggerate. While 31% of assessed valuation, apartment buildings are a lesser percentage of full valuations due to the vagaries of the equalization process. The City Council did recently relax rent control, allowing landlords to pass along half of the fuel-price increase in increased rents. Even this minimal relief barely passed, with only one Manhattan councilman, from Harlem, voting yes.

Clearly the game Mayor Beame is playing is putting himself in position to be forced by others to take painful steps necessary to save the city. He needs someone else to take the initiative so he can have someone else to blame. Politically, the abolition of rent control will be the toughest nut of all to crack, and it is up to the financial community to do the pushing and to take the rap.

Mr. Rockefeller and Mr. Wriston have to start stressing that their banks' trust departments have a fiduciary responsibility when they make investments, and that it's hard to see how a prudent man can buy the bonds of a city that is devouring its own tax base.

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[Unidentified newspaper article]

"Unanimous" rejection of loans on controlled NYC buildings is charged

Lending institutions active in the mortgage investment field "will not consider secure an investment in a rent-controlled apartment house, regardless of money market conditions or current interest rates."

This is the contention of Stephen Fisher, a president of the mortgage brokerage firm bearing his name. He said there is a "unanimous" reluctance to invest in a rent-controlled property among mutual savings banks, commercial banks and trust companies and pension funds and life insurance companies.

"In fact, every one of the major sources with whom we have discussed this problem has emphatically made clear that should controls be extended to post-war apartment houses and new construction they similarly would not consider secure such an investment and would not make a loan."

He noted that local savings institutions that historically have made most of their mortgage loans within the City are now forced to seek investment elsewhere because they cannot find—and the same goes for mortgage brokers—enough of the type of financial security they require within the limits of the five boroughs."



# NEW YORK CITY FINANCIAL CRISIS

SATURDAY, OCTOBER 18, 1975

U.S. SENATE.  
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS,  
*Washington, D.C.*

The committee met at 10:10 a.m., pursuant to call, in room 1202, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, McIntyre, and Brooke.

Also present: Senator Javits and Eagleton.

The CHAIRMAN. The committee will come to order.

Today we conclude hearings on whether to provide financial assistance to New York City. As I said when these hearings began this is a complex and tough issue. But we have to resolve it. We can't duck it. And we have to resolve it quickly. Yesterday's events make it clear that we can't let the issue remain up in the air. Employees and investors can't be required to live under a cloud of impending default much longer. Employees have a need to know whether they will be paid, and with checks that will be honored. Investors can't be asked to advance new credit and put up new money in this situation without knowing whether the Federal Government is going to help.

On Tuesday this committee will begin marking up legislation dealing with the New York financial situation. This doesn't mean we will necessarily report a bill. It means that we will consider such legislation and come to a decision quickly, certainly before the end of the week.

Before we proceed with today's testimony, let me briefly summarize the testimony we received last week.

The testimony was nearly unanimous with the important exception of Secretary Simon that the city cannot avoid default after November without Federal help. Neither the city nor the State has the financial resources to cope with the enormous city debt maturing after November. Neither can borrow to redeem this debt. This would mean sure default soon after December 1 without Federal assistance.

Governor Carey and Felix Rohatyn told the committee that default by the city would cause major State agencies and possibly the State itself to default.

All witnesses told the committee that default by New York City would have adverse effect on municipal and State securities generally. But most were not so optimistic. Some foresaw a disorganized market lasting for years and increasing the cost of raising money to States and municipalities by as much as \$1 billion per year—\$10 billion during the life of the securities.

The testimony also called attention to the financial risk to the U.S. Government that a guarantee would present. The testimony indicated

that this risk could be reduced by providing that revenue sharing funds be attached by the Treasury in the event of default. There was universal agreement that the Federal Government should be compensated for providing the guarantee by making the securities issued by the city taxable. This would net the Federal Government about \$25 million for each billion guaranteed.

On the other hand, witnesses also pointed out that Federal aid to New York might impel other local government units to increase deficit spending. On this, the testimony indicated that such incentive could be reduced by allowing aid to be given only upon proof that the assisted city's fiscal affairs were being closely controlled and supervised by an outside agent or board, and that steps had been taken to achieve true budget balances.

Certainly around the country there is concern that the biggest, richest city in the country and perhaps in the world needs assistance and can't manage its fiscal affairs without the Federal Government stepping in. That's a question we are going to have to decide in this committee and in the Senate and in the Congress.

Today we are going to hear from witnesses who will provide testimony on still other aspects of the question. We will begin with Mayor Beame of New York, Mayor Landrieu of New Orleans, and Mr. John Mulroy representing the National Association of Counties.

Gentlemen, we have 18 witnesses today. We are going to have a session again this afternoon. Under the circumstances, I do hope that you will keep your opening statements as brief as possible. We will be happy to print in full in the record the full text of your statement.

Mayor Beame, go right ahead, sir.

**STATEMENT OF ABRAHAM D. BEAME, MAYOR, NEW YORK CITY; MOON LANDRIEU, MAYOR, NEW ORLEANS; JOHN MULROY, COUNTY EXECUTIVE, ONONDAGA COUNTY, N.Y., REPRESENTING THE NATIONAL ASSOCIATION OF COUNTIES, ACCOMPANIED BY KENNETH AXELSON, DEPUTY MAYOR, NEW YORK CITY; AND IRA MILLSTEIN, ATTORNEY, WEIL, GOTSHAL & MANGES**

MAYOR BEAME. Thank you.

Mr. Chairman and distinguished members of the committee, I want to thank for holding these hearings today and cutting short your home State activities. I think it is because you sense the urgent importance of this issue not only to the city of New York and New York State, but also to the Nation as a whole.

Last week, Governor Carey and others reviewed with you the current New York fiscal situation. As they explained, city and State officials, working with some of the leading banks and financial community leaders in the city, have assembled a delicate and highly complex financing program to maintain a credit lifeline to the city through November.

Yesterday, as you know, our city hovered on the brink of default for agonizing hours until the trustees of the teachers retirement system approved the purchase of State securities essential for meeting debt obligations falling due. Earlier in the week, extraordinary measures were required to prevent the default of the State's housing finance agency.

No additional proof should be needed that the State, the city, and our financial institutions have reached the limit of their credit resources. Despite superhuman efforts, we in New York can no longer singlehandedly reverse the spreading uneasiness in the national securities markets.

There can no longer be any doubt; without appropriate Federal assistance, there will be a municipal default in New York by the end of the year triggering national and international consequences that will touch the lives of every American.

Default is a nonpartisan issue. The impact on the public credit markets will be felt by both Democratic and Republican governments, by municipalities with balanced budgets and those in debt.

Moon Landrieu, president of the U.S. Conference of Mayors, is here to detail the effect New York's protracted crisis has already had on the borrowing plans and the debt costs of the Nation's cities.

I am here today to talk about the people of the city of New York—about the austerities we have accepted, the additional cuts now being imposed, and about our plan for fiscal recovery.

Since the abrupt national slide into recession a little more than 1 year ago, New Yorkers and their public servants have endured over \$1 billion in actual costs—already implemented—affecting every operation of municipal government.

In light of Secretary Simon's proposal for a tax increase as a solution to our difficulties, I would also point out that we did increase a variety of business and commercial taxes by a total of \$330 million at the beginning of this fiscal year. In addition, on September 1, we raised the bus and subway fare 43 percent—from 35 cents to 50 cents. Fees for everything from marriage licenses to concession permits have been increased sharply.

Successive waves of personnel cuts and a virtually complete hiring freeze have reduced the city's payroll by over 31,000 employees since January 1975—10.5 percent of our municipal work force. A wage freeze—voluntarily agreed to by most municipal unions—is in effect for all city workers.

Every neighborhood, every segment of our population, everyone who lives or works in New York City has been affected by these cuts in personnel and services.

Just this week I announced additional cuts totaling \$200 million on an annualized basis to be implemented before the end of this calendar year.

These new economies are the cutting edge of a comprehensive, 3-year financial plan. These economies will be followed by additional retrenchments in the next 2 fiscal years to eliminate an accumulated deficit in our current operating accounts of \$724 million. This plan—required by the same State legislation that provided for our current financing package—is subject to review by an emergency financial control board chaired by the Governor.

I have also set forth the policy guidelines which will shape our future economies—guidelines which constitute nothing less than a revolution in the social and political life of our city. I have proposed radical changes in the structure and financing of the city university system, the closing of underutilized municipal hospitals, and a phaseout of the extra allotments of city tax funds for various social services programs over and above matching grant requirements.

I announced that the city must withdraw from its traditional role as a mortgage and financing source for middle income housing—we must now concentrate on preserving our existing housing stock and encouraging private, State, and Federal financing for housing construction.

Coupled with these efforts, we have already begun the process of paring down the size and expense of city government through management reforms, productivity improvements, and other measures. To assist us in this effort we have recruited top executive talent from some of the leading national corporations headquartered in New York City.

No other unit of government is under such intensive scrutiny from within and without or so open to fundamental change. Our byword is that nothing is sacred.

A new management advisory board—composed of leading business and labor leaders and chaired by Metropolitan Life Insurance president Richard Shinn—is studying opportunities to improve efficiency and reduce costs through changes in day-to-day operations and better utilization of existing technology. The board has also undertaken an intensive study of the municipal pension systems.

I have also established a temporary commission on city finances—composed of outstanding New Yorkers from education, labor, commerce, and finance—which will help develop new strategies for adjusting our financing plans to the realistic limitations of our tax base.

The commission is considering proposals for regional financing of mass transit and is studying the impact of the present city tax structure on business in New York.

To gain a real understanding of the gravity of our crisis—and of the depth of the resources available for meeting that crisis—you must remember the size of the city of New York and the scale of everything there.

With slightly under 8 million residents, the city would rank eighth in population nationally if it were a State. It has as many people as Chicago, Los Angeles, and Houston combined.

But New York is separated from its sister cities by more than size alone. The growth of New York City has shown that urban assets and urban ills increase geometrically as the metropolis gets older.

The fiscal fate that has befallen the city was foreordained in the changing demographic patterns that follows the end of the Second World War, and in national policies and economic trends that sapped the strength of America's big cities in favor of suburban development.

New York City has paid the price, thousands of times over, of the one-way bus tickets that propelled people without money, without skills, without hope into our town from all over the United States.

The problems which New York City has absorbed have multiplied rapidly in the context of our vast metropolis: The Central Brooklyn ghetto alone has more people than Fort Worth or Minneapolis; the number of elderly in my city exceeds the population of Baltimore, and there are more indigent elderly than there are people in Grand Rapids; we have as many children in our public schools as there are people in Milwaukee and Birmingham put together.

How many other States, let alone other cities, could begin to cope with the social problems and fiscal strains associated with these num-

bers? You may ask how we have been able to contain these burdens and stay out of the Nation's headlines and network newscasts for so many years.

The answer, of course, is that New York City is an unparalleled center of business and financial activity—

Total payroll employment in New York City approximately equals that of Michigan;

There are more manufacturing jobs in our city than in the whole of Wisconsin;

There were more manhours worked on the Brooklyn piers last year than in the entire Port of Boston.

As the busiest harbor in the Western Hemisphere, as the center of the Nation's biggest market for goods and services, and as a leading location for new or "embryo" firms, New York City still has a lot of economic muscle.

But from a national perspective, of course, New York is best known as the Nation's capital for corporate headquarters and mass communications, the securities industry, banking and finance, and such specialized services as accounting, public relations, market research, and advertising.

Indeed, the fact that New York City has continued to meet its payrolls and other obligations 7 months after the credit markets were closed to us testifies to the basic strengths of our economic resources. Indeed, on two critical dates in the city's cash flow crisis, we were able to meet all obligations with the assistance of New York corporations, utilities, and banks which made early payment on property taxes. In all, almost \$400 million in early payments was secured.

I have summarized our painful but resolute response to the city's fiscal crisis, and I have weighed for you the scope of both our problems and our assets. We New Yorkers have taken the first, firm steps toward full fiscal recovery, and we have the means and he will to remain a viable city.

Given time, we can complete the process—now well underway—of restructuring our debt burden to scale down our short-term obligations.

We are now financing the city through the Municipal Assistance Corporation and the State, thereby providing additional assurances to investors. We have frozen municipal construction projects "in the pipeline" so as not to incur new capital budget obligations.

Given time, we can overcome our difficulties, and that is what I am asking you for—time. Through a Federal loan guarantee, you can help us maintain a line of credit until we can re-enter the money markets.

There is ample justification for a Federal guarantee of our debt. Official estimates for the past fiscal year show that the U.S. Government already provides about \$202 billion in loan guarantees through various Federal agencies. These include \$85 billion for the Federal Housing Administration, \$14.5 billion under the Farmers Home Administration, \$6 billion through the Small Business Administration and many others through a host of Federal agencies.

In addition, the Export-Import Bank—which helps guarantee financing for American investments in foreign ventures—has loan guarantee authorization for \$4.8 billion. Export-Import Bank guarantees will help finance construction of a sugar mill in Panama—

\$12.7 million, chemical plants in Yugoslavia—\$8 million, and industrial facilities in Brazil—\$17 million. Our Government will also help guarantee financing for the purchase of locomotives in Mexico—\$10.8 million, and the installation of a telephone exchange in Honduras—\$1.7 million.

I do not cite these programs to criticize them. On the contrary, these existing commitments show that the Federal Government has already recognized the necessity of maintaining an open line of credit to preserve and promote sectors of our economy and to encourage stability and development abroad. I cannot understand why this principle should not apply with equal force to New York City under the present circumstances, and to any other city that may find itself in this position.

President Ford has continued to resist aid to the city in the name of preserving the doctrine of "federalism." That argument, in my judgment, is a smokescreen. It comes from the same Federal administration that recently issued orders which would compel State and local legislative action, multimillion dollar capital expenditures, and even zoning charges as requirements for compliance with the Clean Air Act.

Under present Federal and State laws, we must continue to pour hundreds of millions of municipal tax dollars each year into welfare payments. These are programs which provide vital support to indigent New Yorkers but do nothing in themselves to break the cycle of poverty and dependency.

It is a bitter irony to me that, while we must maintain these federally mandated programs, we have been forced to cut deeply into those services and institutions that we have developed to provide a means for families and individuals to break out of that cycle. The latest round of economies will require great additional sacrifices in our public schools and significantly reduce day care, family planning, and community development programs focused in low-income areas. Evening adult education and citizenship training programs provided through our public schools have already been cut deeply.

I know we can make a good case for Federal assistance to the city but I know too that many Americans hold the curious opinion that New York City is somehow not a part of the United States. On the contrary, we are truly an American city. Since its earliest days, our town has epitomized the American spirit of commerce and industry, and given form to the very American ideals of individual opportunity and social justice.

Hundreds of letters from all over the Nation and the world to my office prove that many Americans identify with our city and that many foreigners identify New York with America. Foreign correspondents covering our city hall are incredulous to learn that the world's richest Nation could abandon its preeminent city. Would the French disown Paris? Or the British allow London to become insolvent? Would the Soviets abandon Moscow? The world's great cities have always been the brightest and most enduring symbol of their nations.

But we are more than just a symbol. The city of New York plays a vital and irreplaceable role in American life, as does every other region of the Nation.

And we are now proposing, as an emergency measure to be invoked only under extreme circumstances, a new Federal mechanism that can work to strengthen local governments. We are not asking for any hand-out. We are asking for equal treatment.

A Federal guarantee as an option for municipalities—granted for taxable securities under special circumstances and with appropriate controls—will not threaten the federalist system. Without wholly bypassing the credit markets, it will provide a timely means of preserving the basic unit of our system of government in times of extraordinary economic and social pressures.

Thank you.

The CHAIRMAN. Thank you, Mayor Beame.

Mayor Landrieu, you have a 12-page statement. If you would give us just part of that, we will be happy to print that with the excellent appendices you have presented for the record.

Mayor LANDRIEU. Thank you very much, Mr. Chairman.

I can add very little to the extremely eloquent and persuasive statement made by Mayor Beame on behalf of his city. That statement is thoroughly endorsed by the U.S. Conference of Mayors and the National League of Cities which I represent here today.

There has been some confusion, Mr. Chairman, over the public support for a loan guarantee to New York City. I am here today representing the National League of Cities which has polled its membership, or at least its executive board which is representative of its organization. The National League of Cities represents some 15,000 cities across this country, large and small, and as I pointed out, that board is representative of that membership.

We have submitted a letter for the record which is contained in my statement supporting the position of a loan guarantee for New York City under certain conditions. The board voted 20 to 1 in favor of that position.

The U.S. Conference of Mayors represents cities, or at least the mayors represent cities of over 30,000 in this country. The Executive Committee of the U.S. Conference of Mayors, after great deliberation, has voted 13 to 1 that the aid to New York City that's being requested is absolutely essential.

Some may say what is the concern of the mayor from the Deep South? Why is it that mayors from the West and North are concerned about the problems of New York City which for years, according to some, has lived beyond its means and has poorly managed its affairs? So the allegation goes.

I am concerned first about the 8 million people that live in New York City. I would like to think that this Congress and the national leaders are concerned about 8 million Americans who are going to be very adversely affected by default by New York. I refer not only to the technical default, but an indepth default in which neither its short-term nor permanent obligations are met and even more hazardly its current operating expenses cannot be met.

There are those who say we do not know the consequences of such an act and are prepared to test what those consequences will be. Those of us that manage the larger cities of this country and the smaller cities of this country are not prepared to take that risk. We are already sharing the cost of New York's dilemma. The cost of borrowing money

to all cities has increased and in some instances the market has been closed.

At the mere fright of New York's bankruptcy, Atlanta, with an AAA rating, was not able to market its bonds a week ago. Detroit recently had to borrow money at 9.9 percent, which is an unheard of rate in the municipal bond market, and as has been pointed out by Congress, that represents a 20-percent yield to an investor in a 50-percent tax bracket.

But I have been dismayed at the campaign that has been waged, not in an effort to put together a constructive solution to New York's problem, but rather to divide this country on the issue and to suggest that money is going to be taken from every city and every citizen of this Nation and shipped to New York City. Nothing could be further from the truth and we have never asked that on behalf of New York City. We have asked only that the Federal Government create a market in which New York can borrow to meet its current emergencies and then give them time to work out their affairs. That's the truth of what's being requested.

The question that is being put to so many across this country is one that is designed to inflame, one that is constructed in order to obtain a negative answer: Do you want your tax dollars sent to New York City to bail out an extravagant administration? And obviously, the answer to that question is going to be "no."

But that isn't the question being put and when it's properly placed you get almost a unanimous position from mayors and from councilmen across this country. I sat here a week ago, Mr. Chairman, and was appalled at the information that was expressed from certain Senators present. I thought perhaps that my confidence and faith in New York City had been misplaced, that indeed maybe it had been extravagant to an extreme if the figures which were being submitted were correct; but I couldn't believe those figures and I asked our staff to do an analysis of those figures and they have, and they present an entirely different picture.

With your permission, Mr. Chairman, I'd like to direct your attention to table 3 of my statement. We were advised that the capital expenditure of New York City, as I recall, was somewhere around \$1,400 per person, and how was it possible that the mayors of other cities with expenditures of one-fourth to one-third could be here in support of that kind of profligacy.

The fact of the matter is that New York City, unlike many other cities across this country, performs many of the functions which are normally performed by State governments and when you begin to isolate from the New York budget such things as the Port Authority and the Airport and when you begin to add into other cities' budgets, schools, and functions performed by county governments, you find that the per capita expenditure per New York resident is not out of line with other major cities across this country.

For instance, for New York City, \$435; for Boston, \$441; Chicago, \$383; Newark, \$449; Philadelphia, \$395; and San Francisco, \$488. Indeed, the per capita expenditure when appropriately balanced and when the functions are isolated are not excessive when compared with other cities across this country.

We also heard some astounding figures on the number of public employees that New York City had in comparison to others and, of course, that is a simple error into one can fall if you simply take all the employees on New York's payroll and divide it by the residents of New York City. What it doesn't say, for instance, is that a city such as New Orleans does not have the responsibility for transit. It's operated by a public utility company and all those employees do not find their way into our public payroll. We have a separate airport authority. The Port of New Orleans, the second greatest port in this Nation, is not run by the city of New Orleans, but by a State agency. All of the school employees do not find their way into my city budget but rather into a separate school budget.

Mr. Chairman, when those factors are correlated, we also get some enlightened results, because when all the municipal functions are combined and subtracted, New York comes out at a ratio of 242 per 10,000 people; Newark has 258; Philadelphia has 255; Baltimore has 260.

Consequently, it would appear to me that despite the enormous service that New York City has provided—not only for its own citizens and the millions living immediately outside of its border but for the millions and millions of Americans as a national service center, that it has not done all bad.

In addition to a concern for my city and the other cities who are experiencing increasing borrowing costs, perhaps I have a bit of sentimentality attached and a bit of love for New York City. I found at the hearing last week that things I most admired in this country had all of a sudden become outdated. The concept of the ability of a person to move to an area where opportunity was great—New York has provided that for this Nation. The feeling that every child in this country, irrespective of economic condition, if he had the intelligence and the capability, ought to have easy access to education, particularly higher education. New York City has provided that.

And yet because it has for over 100 years, it's made to look profligate. The concept of freedom of expression and freedom of life style which represents the things that this country stands for—at least that I thought that it stood for—New York now finds itself criticized.

I don't suggest to you that everything has been right with New York City, but I do suggest that the opponents of aid to that city and those who have resisted developing a national policy on behalf of all cities have rather badly distorted the record, and I think that it needs to be corrected.

I might say one other thing, Mr. Chairman, in closing; that there has been published a report by the Congress of the United States Congressional Budget Office, which I recommend to you for reading. It's one of the best prepared documents I have ever read, not only on the problem of New York but on the urban crisis facing this country, and it points out that there has not been, in effect, an urban policy in this country that would deal with the crisis that New York is facing nor that which is facing the other major and older cities of this country, and it points out very effectively that an urban policy does indeed have to be developed if other cities are not to follow the path of New York City.

I would like to read, if you will permit, Mr. Chairman, just the final conclusion of that report which is on the back page. It says:

The focus of this paper has been largely on the immediate crisis facing New York City and the alternative policy responses to this situation. However, the crisis will only be delayed temporarily unless the underlying causes of the cities' fiscal difficulties are addressed. While it may be comforting to believe that these problems can be handled by the city alone, this probably is not the case. Certainly, efficient management, strict economy practices and the introduction of new technology can help, but such measures alone will not balance New York City's budget and pay off a substantial portion of its accumulated short-term debt. Substantial service cutbacks and tax increases will be required to accomplish these objectives and yet such actions will make the city a less attractive place in which to live and probably will hasten the exodus of middle and upper income families and commercial and industrial establishments. This, in turn, will cut the city's ability to support even a reduced level of services. Given these forces, it is probable that the underlying problems facing New York, as well as a number of other large aging cities, can be dealt with effectively only by the states or by the Federal Government unless one is willing to consider policies that would redistribute the low income populations among other jurisdictions or would redraw city boundaries so as to encompass suburban areas or would radically equalize income. The main alternative left for addressing the city's problems is to relieve the city of some major portion of its current fiscal responsibility. As has been mentioned previously, the New York situation could be helped immensely if the state or the Federal Government assumed the burden now borne by the city by welfare and related services to the poor.

In conclusion, Mr. Chairman, we are not only directing our attention here today to what is immediately before us, and that is the solving of New York's fiscal crisis, but the ultimate solution of the problem facing New York City and Detroit and St. Louis and Cleveland and Boston and New Orleans and every other major city in this country, and the policies that we adopt today, the attitudes that we strike in this country now will ultimately affect the national policies insofar as it concerns all of our cities. There are no more important assets in this country than the cities of the nation.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mayor Landrieu.

[Complete statements of Mayors Beame and Landrieu follow:]

TESTIMONY BY MAYOR ABRAHAM D. BEAME  
BEFORE THE U.S. SENATE BANKING, HOUSING,  
AND URBAN AFFAIRS COMMITTEE  
DIRKSEN SENATE OFFICE BUILDING  
WASHINGTON, D.C.  
SATURDAY, OCTOBER 18, 1975

Mr. Chairman, members of the Committee:

I want to thank you for holding these hearings today and cutting short your home state activities. I think it is because you sense the urgent importance of this issue not only to the City of New York and New York State, but also to the nation as a whole.

Last week, Governor Carey and others reviewed with you the current New York fiscal situation. As they explained, City and State officials--working with some of the leading banks and financial community leaders in the City--have assembled a delicate and highly complex financing program to maintain a credit lifeline to the City through November.

Yesterday, as you know, our City hovered on the brink of default for agonizing hours until the trustees of the Teachers Retirement System approved the purchase of State securities essential for meeting debt obligations falling due. Earlier in the week, extraordinary measures were required to prevent the default of the State's Housing Finance Agency.

No additional proof should be needed that the State, the City, and our financial institutions have reached the limit of their credit resources. Despite superhuman efforts, we in New York can no longer singlehandedly reverse the spreading uneasiness in the national securities markets.

There can no longer be any doubt; without appropriate federal assistance, the City of New York will default by the end of the year, triggering national and international consequences that will touch the lives of every American.

Default is a non-partisan issue. The impact on the public credit markets will be felt by both Democratic and Republican governments, by municipalities with balanced budgets and those in debt.

Moon Landrieu, President of the U.S. Conference of Mayors, is here to detail the effect New York's protracted crisis has already had on the borrowing plans and the debt costs of the nation's cities.

I am here today to talk about the people of the City of New York--about the austerities we have accepted, the additional cuts now being imposed, and about our plan for fiscal recovery.

Since the abrupt national slide into recession a little more than a year ago, New Yorkers and their public servants have endured over one billion dollars in actual cuts--already implemented--affecting every operation of municipal government.

In light of Secretary Simon's proposal for a tax increase as a solution to our difficulties, I would also point out that we did increase a variety of business and commercial taxes by a total of \$330 million at the beginning of this

fiscal year. In addition, on September first, we raised the bus and subway fare 43%--from 35 to 50 cents. Fees for everything from marriage licenses to concession permits have been increased sharply.

Successive waves of personnel cuts and a virtually complete hiring freeze have reduced the City's payroll by over 31,000 employees since January, 1975--10.5% of our municipal workforce. A wage freeze--voluntarily agreed to by most municipal unions--is in effect for all City workers.

Every neighborhood, every segment of our population, everyone who lives or works in New York City has been affected by these cuts in personnel and services.

Just this week, I announced additional cuts totalling \$200 million on an annualized basis to be implemented before the end of this calendar year.

These new economies are the cutting edge of a comprehensive, three-year financial plan. These economies will be followed by additional retrenchments in the next two fiscal years to eliminate an accumulated deficit in our current operating accounts of \$724 million. This plan--required by the same State legislation that provided for our current financing package--is subject to review by an Emergency Financial Control Board chaired by the Governor.

I have also set forth the policy guidelines which will shape our future economies--guidelines which constitute nothing less than a revolution in the social and political life of our City. I have proposed radical changes in the structure and financing of the City University system, the closing of underutilized municipal hospitals, and a phase-out of the extra allotments of City tax funds for various social services programs over and above matching grant requirements.

I announced that the City must withdraw from its traditional role as a mortgage and financing source for middle-income housing--we must now concentrate on preserving our existing housing stock and encouraging private, state and federal financing for housing construction.

Coupled with these efforts, we have already begun the process of paring down the size and expense of City government through management reforms, productivity improvements, and other measures. To assist us in this effort, we have recruited top executive talent from some of the leading national corporations headquartered in New York City.

No other unit of government is under such intensive scrutiny from within and without or so open to fundamental change. Our byword is that nothing is sacred.

A new Management Advisory Board--composed of leading business and labor leaders and chaired by Metropolitan Life Insurance President Richard Shinn--is studying opportunities to

improve efficiency and reduce costs through changes in day-to-day operations and better utilization of existing technology. The Board has also undertaken an intensive study of the municipal pension systems.

I have also established a Temporary Commission on City Finances--composed of outstanding New Yorkers from education, labor, commerce, and finance--which will help develop new strategies for adjusting our financing plans to the realistic limitations of our tax base.

The Commission is considering proposals for regional financing of mass transit and is studying the impact of the present City tax structure on business in New York.

To gain a real understanding of the gravity of our crisis--and of the depth of the resources available for meeting that crisis--you must remember the size of the City of New York and the scale of everything there.

With slightly under eight million residents, the City would rank eighth in population nationally if it were a state. It has as many people as Chicago, Los Angeles, and Houston combined.

But New York is separated from its sister cities by more than size alone. The growth of New York City has shown that urban assets and urban ills increase geometrically as the metropolis gets older.

The fiscal fate that has befallen the City was foreordained in the changing demographic patterns that followed the end of the Second World War, and in national policies and economic trends that sapped the strength of America's big cities in favor of suburban development.

New York City has paid the price, thousands of times over, of the one-way bus tickets that propelled people without money, without skills, without hope into our town from all over the United States.

The problems which New York City has absorbed have multiplied rapidly in the context of our vast metropolis--

- the Central Brooklyn ghetto alone has more people than Fort Worth or Minneapolis
- the number of elderly in my City exceeds the population of Baltimore, and there are more indigent elderly than there are people in Grand Rapids
- we have as many children in our public schools as there are people in Milwaukee and Birmingham put together.

How many other states, let alone other cities, could begin to cope with the social problems and fiscal strains associated with these numbers? You may ask how we have been able to contain these burdens and stay out of the nation's headlines and network newscasts for so many years.

The answer, of course, is that New York City is an unparalleled center of business and financial activity--

- total payroll employment in New York City approximately equals that of Michigan
- there are more manufacturing jobs in our City than in the whole of Wisconsin
- there were more manhours worked on the Brooklyn piers last year than in the entire port of Boston

As the busiest harbor in the Western Hemisphere, as the center of the nation's biggest market for goods and services, and as a leading location for new or "embryo" firms, New York City still has a lot of economic muscle.

But from a national perspective, of course, New York is best known as the nation's capital for corporate headquarters and mass communications, the securities industry, banking and finance, and such specialized services as accounting, public relations, market research, and advertising.

Indeed, the fact that New York City has continued to meet its payrolls and other obligations seven months after the credit markets were closed to us testifies to the basic strengths of our economic resources. Indeed, on two critical dates in the City's cash flow crisis, we were able to meet all obligations with the assistance of New York corporations, utilities and banks which made early payment on property taxes. In all, almost \$400 million in early payments was secured.

I have summarized our painful but resolute response to the City's fiscal crisis, and I have weighed for you the scope of both our problems and our assets. We New Yorkers have taken the first, firm steps towards full fiscal recovery, and we have the means and the will to remain a viable City.

Given time, we can complete the process--now well underway--of restructuring our debt burden to scale down our short-term obligations.

We are now financing the City through the Municipal Assistance Corporation and the State, thereby providing additional assurances to investors. We have frozen municipal construction projects "in the pipeline" so as not to incur new Capital Budget obligations.

Given time, we can overcome our difficulties, and that is what I am asking you for--time. Through a federal loan guarantee, you can help us maintain a line of credit until we can re-enter the money markets.

There is ample justification for a federal guarantee of our debt. Official estimates for the past fiscal year show that the U.S. government already provides about \$202 billion in loan guarantees through various federal agencies. These include \$85 billion for the Federal Housing Administration, \$14.5 billion under the Farmers Home Administration, \$6.0 billion through the Small Business Administration and many others through a host of federal agencies.

In addition, the Export-Import Bank--which helps guarantee financing for American investments in foreign ventures--has loan guarantee authorization for \$4.8 billion. Ex-Im Bank guarantees will help finance construction of a sugar mill in Panama (\$12.7 M), chemical plants in Yugoslavia (\$8.0 M), and industrial facilities in Brazil (\$17 M). Our government will

also help guarantee financing for the purchase of locomotives in Mexico (\$10.8 M) and the installation of a telephone exchange in Honduras (\$1.7 M).

I do not cite these programs to criticize them. On the contrary, these existing commitments show that the federal government has already recognized the necessity of maintaining an open line of credit to preserve and promote sectors of our economy and to encourage stability and development abroad. I cannot understand why this principle should not apply with equal force to New York City under the present circumstances.

President Ford has continued to resist aid to the City in the name of preserving the doctrine of "federalism." That argument is a smokescreen. It comes from the same federal administration that recently issued orders which would compel state and local legislative action, multi-million dollar capital expenditures, and even zoning changes as requirements for compliance with the Clean Air Act.

Under present federal and state laws, we must continue to pour hundreds of millions of municipal tax dollars each year into welfare payments. These are programs which provide vital support to indigent New Yorkers but do nothing in themselves to break the cycle of poverty and dependency.

It is a bitter irony to see that, while we must maintain these federally mandated programs, we have been forced to cut deeply into those services and institutions that we have

developed to provide a means for families and individuals to break out of that cycle. The latest round of economies will require great sacrifices in our public schools and significantly reduce day care, family planning, and community development programs focused in low-income areas. Evening adult education and citizenship training programs provided through our public schools have already been cut deeply.

I know we can make a good case for federal assistance to the City, but I know too that many Americans hold the curious opinion that New York City is somehow not a part of the United States. On the contrary, we are truly an American city. Since its earliest days, our town has epitomized the American spirit of commerce and industry, and given form to the very American ideals of individual opportunity and social justice.

Hundreds of letters from all over the nation and the world to my office prove that many Americans identify with our City and that many foreigners identify New York with America. Foreign correspondents covering our City Hall are incredulous to learn that the world's richest nation could abandon its pre-eminent City. Would the French disown Paris? Or the British allow London to become insolvent? Would the Soviets abandon Moscow? The world's great cities have always been the brightest and most enduring symbol of their nations.

But we are more than just a symbol. The City of New York plays a vital and irreplaceable role in American life, as does every other region of the nation.

And we are now proposing, as an emergency measure to be invoked only under extreme circumstances, a new federal mechanism that can work to strengthen local governments.

A federal guarantee as an option for municipalities--granted for taxable securities under special circumstances and with appropriate controls--will not threaten the federalist system. Without wholly bypassing the credit markets, it will provide a timely means of preserving the basic unit of our system of government in times of extraordinary economic and social pressures.

Thank you.

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**NATIONAL LEAGUE OF CITIES**



**UNITED STATES CONFERENCE OF MAYORS**

STATEMENT BY

THE HONORABLE MOON LANDRIEU  
MAYOR OF NEW ORLEANS, LOUISIANA

and

PRESIDENT OF THE UNITED STATES CONFERENCE OF MAYORS

on behalf of

THE UNITED STATES CONFERENCE OF MAYORS

and

THE NATIONAL LEAGUE OF CITIES

on

EMERGENCY LOAN GUARANTEES FOR STATES AND  
LOCAL GOVERNMENT: A LEGISLATIVE PROPOSAL

before the

SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

October 18, 1975

1620 Eye Street, N.W., Washington D. C. 20006 / 202-293-7300

Mr. Chairman, distinguished members of the United States Senate Committee on Banking, Housing and Urban Affairs.

I am Moon Landrieu, Mayor of the City of New Orleans and President of the United States Conference of Mayors. I speak to you today not only on behalf of the Conference of Mayors, the national spokesman for Mayors of virtually all cities with population in excess of 30,000 but also on behalf of the National League of Cities, the national representative for approximately 15,000 municipal governments in all fifty states and Puerto Rico. We have been pleased to work with this Committee over the years on such issues as community development legislation; and, we are indeed pleased that his Committee and its Chairman, Senator Proxmire, are, once again, demonstrating their outstanding leadership by initiating legislative hearings on the issue of a federal program to prevent the unnecessary default of the City of New York -- an issue of utmost importance to the future of our urban centers, to the nation's economic system and, indeed, to our entire federal system of government.

Mr. Chairman, you and your colleagues on this Committee have heard from a number of people representing a number of diverse interests about the fiscal crisis confronting New York City and New York State. This is not a new topic of discussion for the Mayors of this country. More than one year ago, the U.S. Conference of Mayors testified in this very Senate Office Building before the Subcommittee on Financial Markets of the Senate Committee on Finance on the crisis in the municipal bond market. The then-President of the Conference, Mayor Joseph Alioto of San Francisco, together with Mayor Abraham Beame, who is here with me today, discussed the critical situation that cities were facing then

in selling their municipal bonds. We stated then that if the Federal government did nothing to increase the supply of credit available to state and local governments, the situation would deteriorate rapidly. But, we had no idea that it would reach the point where the premier city of this country and, perhaps of the world -- New York City -- faces imminent default on outstanding debt unless it obtains access to the bond market.

The economic and financial impact of New York City's financial crisis on the nation's cities and the great uncertainty about the consequences of default motivated both the National League of Cities and the U.S. Conference of Mayors to act. In mid-September, the Executive Committee of the Conference adopted a policy of federal guarantee of bonds of states and municipalities with such bonds being subject to federal taxation. Such taxable securities would be guaranteed only after stringent conditions were met such as the unavailability of credit from other sources and real evidence given that revenues are sufficient to cover repayment.

Subsequent to the adoption of this policy, fourteen Mayors of the Executive Committee of the Conference testified before the Joint Economic Committee as it assessed the consequences and the possibilities of a New York City default. We pointed out that the problems of New York City were not unique to that one city -- the seeds of the New York crisis are throughout the nation. The Mayors appearing that day represented a cross-section of the United States, both in terms of geography and in population bases -- the Mayors of Newark; Syracuse; San Francisco; Milwaukee; San Leandro, California; Gary; Denver; Anchorage, Alaska; New York; Detroit; Cleveland; San Juan, Puerto Rico;

and New Orleans. We were concerned then as we are today about the impact of a possible New York default on the people of New York City, Detroit, San Francisco, Cleveland, and all over this country. We were concerned then as we are today that the collapse of New York City or default by New York of its obligations will make it extremely difficult, if not impossible, for any city to borrow money. The impact was being felt then and it continues to be felt. Atlanta, a triple A rated city, went to the market two weeks ago and had no takers. Detroit recently paid 9.9%, 1/10th of 1 percent shy of the Michigan statutory limit on the amount of interest that can be paid on an issue. States and cities around the country are being slapped with higher-than-normal interest rates due to, according to the bond counsels advising these governments, the uncertainty created by New York City's financial crisis. These examples are supported by the data presented in Table 1 - Municipal Bond Average Yields, which is attached. At 7.67%, average yields for October, 1975 were at their highest level for the four and one-half years covered in the table.

Simply stated, during the past few months, cities are offering issues and are either not receiving bona fide bids or they are receiving record high bids which they must unwillingly accept if the funds are absolutely necessary or they reject the bids.

Three factors prevent municipalities from borrowing when interest rates drastically climb.

First, in many states and municipalities, there are statutory limits on the amount of interest that can be paid on an issue such as in Michigan to which I just referred. Second, many local officials refuse to accept the higher interest rates knowing that the taxpayers in their cities would be burdened with the additional costs, for

example, a 1% increase in interest rate over a 10-year period on a \$10 million bond would cost city taxpayers an additional half million dollars. And, lastly, under the kind of tight money and recession conditions we are in today, the buyers of municipal bonds go elsewhere -- especially true of the large commercial banks. As shown in Table 2, during the first quarter of 1975, commercial banks dropped out of the municipal bond market almost entirely. There has been a basic change in the market: commercial banks, enjoying newer tax loopholes (such as foreign investment) no longer need the tax-exempt income.

The unavailability of necessary capital at reasonable interest rates has had major consequences for the economic recovery which some say is occurring at the present time. Debt financing is used to construct needed public facilities -- schools, roads, mass transit facilities, libraries, hospitals. If the necessary capital is not obtainable through the issuance of municipal bonds, then these needed public facilities do not get built. They get indefinitely postponed. In inflationary times, this means skyrocketing costs which must ultimately be borne by the taxpayer. Moreover, capital improvements projects are needed now -- not three years from now -- to stimulate economic activity. Construction of public facilities is an effective anti-recession tool.

At this time, I would like to submit for the record a letter from Alan Beals, Executive Vice-President of the National League of Cities, which details the policy position of the League on federal intervention in this emergency situation.

When the Conference of Mayors testified before the Joint Economic Committee on September 24, 1975, we had little support from other interests for the position we advocated. Since then, however,

endorsement of a variety of federal emergency measures to meet the issue of municipal default has come from the Municipal Finance Officers Association, the rating agency of Standard & Poor's, leading investment bankers, the Democratic governors, and leading European bankers. Indeed, Arthur Burns, Chairman of the Federal Reserve Board, in recent testimony before the Joint Economic Committee, admitted that the impact of the New York City crisis was far greater than he envisioned and that it could trigger a recession, although unlikely. He, however, did not rule out Federal intervention and proposed guidelines for any Congressional action. He urged "quick action" if Congress decided to act. Just this week, even Vice President Rockefeller departed from the Administration's stated position and called for Federal intervention. Only the Administration seems consistent in its opposition to a Federal solution to New York City's financial problems.

On September 24, the Executive Committee of the Conference of Mayors met with the President, his Domestic Council and Secretary Lynn of OMB. At that time, we presented what we felt were the consequences of a default by New York City and we set forth what we felt would be a possible solution -- Federal guarantee of taxable bonds so that New York City would gain access to the market while it gets its budget into balance.

The President did not support our proposal. He reaffirmed his philosophical concern about the intervention of the Federal Government into a local matter of this nature. Moreover, he suggested that perhaps there was something more that the State of New York could do in this situation than it has done in the past.

Senators, you have heard from the Governor of the State of New York as well as from Felix Rohatyn, Chairman of the Municipal Assistance Corporation of New York. You are well aware of the many steps taken

by the State of New York in recent months to assist the City from advancing State aid payments to the City, the setting up of the Municipal Assistance Corporation to the commitment of State and pension funds to meet the City's financing requirements. Recently, Standard and Poor's, which rates the risk associated with various municipal bonds, warned that if the state extended more assistance to New York City than that called for in the September emergency plan, it would be compromising its fiscal integrity and jeopardizing its high credit rating. Moody's Investors Service withdrew its rating from the state's Housing Finance Agency and lowered its rating of New York State securities. I think we should put to rest the argument that perhaps the State of New York could do more than it already has. New York City's budget is larger than the State of New York -- it is larger than the Southern states of Louisiana, Mississippi, Alabama, Georgia, and several others put together. It is inconceivable to me that an institution of that financial magnitude would be left unaided by the only institution in the world that can be of assistance to it at this point. That is the Federal Government.

The President's concern that Federal intervention into a local matter would be establishing a dangerous precedent is an untenable position. We pointed out to the President that there have been many incidents where the federal government has not hesitated to "interfere" in local municipal operations through legislation and through the federal courts.

To cite just one example, court orders are now being enforced in Boston and in Louisville pertaining to busing of school children. The question at issue is not whether these court orders are fair or whether they are unjust. The fact of the matter is they are being

enforced. These are not orders issued by any city council or by the Mayor but by Federal edicts. And, they are costly to local government. According to Mayor Kevin White, it is going to cost Boston approximately \$30 million to enforce the court order.

Cities have had minimum wage bills, safety standards, social security increases and more, handed down from the federal level without any "philosophical" concern about the intervention of the Federal Government into a local matter about which the Administration now seems so concerned. Moreover, we have to pay the bill. We have been mandated by various legislative acts of the Federal government and various judicial decrees to upgrade certain services, to improve facilities, and to do a multitude of other things with no concern for where the money is coming from. For your review, I have attached to this testimony Appendix A which lists just some of the types of Federal mandates and court decisions which have significant impact on city budgets. This list is in no way an exhaustive one. However, it does illustrate the point that there's no justification for the Administration's concern about establishing a precedent of federal involvement in local issues -- it goes on all the time.

Mr. Chairman, I should like to explain the reasons why the National League of Cities and the U.S. Conference of Mayors have chosen to support federal guarantee of taxable bonds for those States and municipalities facing financial emergency rather than some other federal proposal. But, before I do, permit me to raise one other issue which disturbs me. I was present, in the audience, for the first day of these hearings -- October 9. There were several comments made that day, by some of your colleagues on the Committee as well as by one of the witnesses, to which I must take exception and respond.

From these comments, I sensed a strong feeling that New York City should be punished for its past. A past of what? For more than 300 years, New York City has served America and the world. Countless millions of people have entered this country through New York City and millions chose to stay. Hundreds of thousands of the poor and jobless from the South and Puerto Rico have migrated to New York seeking a better life. New York has had absolutely no control over this migration and has been unable to exercise control over the millions who live on its borders and use its services.

Is this the past for which the City must be punished? I would hope not. At the October 9 hearing, figures were being cited to support claims that New York City has lived beyond its means, that it has over-spent and capitulated to the demands of public employee unions, welfare recipients and university students. Data were cited to support the claim that New York City is far out of line with other large municipal governments when their expenditure and employment patterns are compared. I submit for your review data obtained from the U.S. Bureau of Census and reported in the October 10, 1975 Congressional Budget Office report entitled, "New York City's Fiscal Problem: Its Origins, Potential Repercussions, and Some Alternative Policy Responses," (Tables 3 and 4) which correct this misleading conclusion. New York City provides services that in other areas may be supplied by a county government, a school district, or another specialized government. Therefore, it is necessary to compare the New York City employment and spending patterns with those of all of the local governments providing services to the residents of other large cities. When this is done, we find that New York City is not so extraordinary. In fact, its per capita expenditure of \$435 on

the eight common municipal functions defined is less than Boston's (\$441) Newark's (\$449), San Francisco's (\$488), and Baltimore's (\$470) comparable per capita expenditures. Table 3 also points out that New York City's employment per 10,000 resident of 242.9 for the common municipal functions is less than comparable employment in Newark (258.2), Philadelphia (255.2), San Francisco (244.6), and Baltimore (260.1).

With respect to the salaries paid public employees, New York is generous but certainly not the most generous of large cities (See Table 4). Indeed, when one considers the fact that New York City's Cost of Living (as measured by the Bureau of Labor Statistics intermediate family budget) is surpassed only by that of Boston, its wages are not particularly out of line. (Table 4, Column 2).

The remaining tables attached to this testimony lend support to the points I am raising today. They are for your review and consideration during your current deliberations on federal legislation to meet the immediate financial emergency. These data are important in another respect. They reflect another trend that we have been speaking out on innumerable times -- there is a need for a basic rethinking of the functions and responsibilities of each level of government within our system and the manner in which financial resources to meet these responsibilities are to be collected and disbursed. The cities of this nation have the expenditure problems in our system. However, the resources necessary to meet their expenditures are found elsewhere within the system.

We support a strong federal system. The strength of such a system requires that each of the partners be strong. Unfortunately, this is not the case and until resources and demands become more

balanced throughout the system, cities will continue to be less-than-a full participant in the partnership. My hope is that after we solve this immediate emergency situation, we -- Congress, the Administration, Governors and Mayors -- address these basic issues and begin to develop long-term responses to prevent the recurrence of any similar fiscal emergency.

I will not waste any further time by discussing misinterpretations of data, and who is to be blamed for what. I am here, on behalf of the League and the Conference, to seek this Committee's support of Federal guarantees on taxable bonds of States and municipalities facing financial disaster. I believe there are two such legislative proposals in front of this Committee at the present time.

Even though the Conference and the League have strong policy positions on the maintenance of the tax exempt status of local borrowing, we do advocate that securities covered by the Federal guarantee being proposed be taxable for three reasons:

- To prevent the downgrading of other taxable securities because a tax exempt and guaranteed security would be superior to every other security in the market. This would possibly threaten the United States Treasury's ability to continue to meet its needs to borrow.
- It would remove New York City from the tax exempt market in the short run and thus reduce the capital shortage in that market which is one of the causes for the increased interest rates now being asked of every city going to the bond market.
- The taxes on the bond's income would yield revenue for the federal government.

Since municipalities consider the maintenance of their tax exempt status on securities to be vital to their fiscal survival, we can assure you that adoption of the kind of legislation we are supporting will not open the flood gates. Cities will not rush in to take

advantage of the guarantee. There will not be a "domino" effect.

This is even more true when one examines the kinds of stringent criteria that are being proposed in the legislative packages which must be met before any state or municipality could be eligible for the guarantee. In order to qualify under the proposals, a state or local government must have failed in a bonafide attempt to obtain private financing. In addition, in the case of local government, the state must demonstrate to the federal government that it has given the local government as much assistance as possible without jeopardizing its own credit worthiness. Finally, any eligible state or local government must submit to the Federal Board created under the legislation a detailed financing plan detailing projected revenues, expenditures, scheduled borrowings, debt service costs and other information the Board may require. The eligible applicant must give evidence to show that its budget will be in balance within a two-to-three year period.

I believe that I accurately reflect the thinking of Mayors across this country when I say that none of them would opt for these kinds of severe criteria being imposed on them and their residents unless forced to do so as a last resort.

We are not asking for "hand-outs". We are asking for New York City, and any other municipality or state if faced with the financial disaster New York confronts, to be given the assurance that the Federal government will back it while it gets its expenditures in line with revenues. New York has been told that it has erred in the past and that it must now correct these mistakes. But, to do this, the City needs some time. And, it needs the assurance that it will have access to the bond market during this period of recovery. There is only one government, gentlemen, which can provide this kind of assurance. That is the Federal

government.

It would be an inexcusable tragedy if the Federal government, for whatever reasons be they fiscal prudence or policies of punishment, denied assistance and permitted default by New York City. I strongly believe that such inaction on the part of the Federal government would threaten the very foundation of this country's credit system and seriously erode the integrity of our credit standing internationally. Serious damage to the United States' economic recovery would surely accompany a default. And, who can accurately assess the disastrous effects a default would have on the eight million people living in New York City and the millions of residents of cities throughout this country?

Mr. Chairman, we ask for immediate action on the part of this Committee on Federal legislation to prevent a most costly mistake. The United States Conference of Mayors and the National League of Cities are prepared to assist you in any way during your deliberations. Thank you for the time you have given us today.

TABLE 1  
MUNICIPAL BOND AVERAGE YIELDS

	TWENTY BONDS*				
	1975%	1974%	1973%	1972%	1971%
Jan.	7.08	5.18	5.08	5.03	5.74
Feb.	6.34	5.16	5.16	5.35	5.27
Mar.	6.54	5.27	5.22	5.29	5.37
Apr.	6.93	5.73	5.22	5.49	5.15
May	6.95	5.91	5.10	5.35	5.84
June	7.05	6.01	5.13	5.15	5.70
July	6.96	6.64	5.34	5.43	6.19
Aug.	7.16	6.70	5.59	5.32	6.07
Sept.	7.34	6.88	5.18	5.39	5.39
Oct.	7.67	6.68	5.04	5.22	5.17
Nov.	----	6.66	5.17	5.04	4.99
Dec.	----	6.89	5.15	4.96	5.44

The average rating of the 20 bonds used in this index falls midway between the four top groups as classified by Moody's Investors Service.

\* Indices are as of the first Thursday of each month.

20 BONDS USED IN COMPILING THE INDEX (20-Year Maturity)			
	Moody's Rating		Moody's Rating
California	Aaa	Baltimore, Md.	A
Illinois	Aaa	Boston, Mass.	A
North Carolina	Aaa	Cleveland, Ohio	A
Chicago, Ill.	Aa	Massachusetts	A1
Columbus, Ohio	Aa	Nassau Co., N.Y.	A1
Delaware	Aa	New Orleans, La.	A1
Denver, Colo.	Aa	Pennsylvania	A1
Memphis, Tenn.	Aa	Pittsburgh, Pa.	A1
*New Jersey	Aa	Philadelphia, Pa.	A
*New York State	Aa	Detroit, Mich.	Baa

Source: The Weekly Bond Buyer, Tuesday, October 14, 1975, Vol. 201 No. 4304.

TABLE 2

ANNUAL NET CHANGES IN HOLDINGS OF MUNICIPAL SECURITIES BY MAJOR HOLDER GROUPS (1970-1975)							
(Amounts are par values in billions of dollars)							
Holder	1970	1971	1972	1973	1974	1975*	
						First Quarter	Second Quarter
Commercial banks	10.7	12.6	7.2	5.7	5.5	-2.7	6.9
Households	- .8	- .2	1.0	4.3	10.0	13.9	9.3
All other**	1.3	5.2	6.2	3.7	1.9	1.9	4.5
Total	11.2	17.6	14.4	13.7	17.4	14.0	20.7

Source: Unpublished flow of funds data from the Board of Governors  
of the Federal Reserve System (Processed: August 19, 1975)

\* Annual rate.

\*\* This includes corporate business, state and local general funds,  
mutual savings banks, insurance companies, state and local  
government retirement funds, and brokers and dealers.

Table reproduced from Robert D. Reischauer "New York City's  
Fiscal Problems" Congressional Budget Office, October 10, 1975.

TABLE 3

NEW YORK CITY EXPENDITURES, EMPLOYMENT AND COST OF LIVING  
COMPARED TO OTHER LARGE CENTRAL CITIES

CITY	(1) PER CAPITA EXPENDITURES 1972-1973			(2) LOCAL GOVERNMENT EMPLOYMENT PER 10,000			(3) COST OF BLS'S INTERMEDIATE FAMILY BUDGET (INDEX 1974)
	(a)	(b)	(c)	(a)	(b)	(c)	
	CENTRAL CITY GOVERN- MENT	ALL LOCAL GOVERNMENTS SERVING CENTRAL COUNTY TOTAL	COMMON MUNI- CIPAL FUNC- TIONS**	CENTRAL CITY GOVERN- MENT	ALL LOCAL GOVERNMENTS* SERVING CENTRAL COUNTY TOTAL	COMMON MUNICIPAL FUNCTIONS**	
New York City	\$1,224	\$1,286	\$435	517.1	528.2	242.9	116
Boston	858	756	441	378.0	465.0	219.2	117
Chicago	267	600	383	140.0	352.5	208.4	103
Newark	692	827	449	391.1	421.5	258.2	116
Los Angeles	242	759	408	162.2	401.1	206.2	98
Philadelphia	415	653	395	163.8	414.5	255.2	103
San Francisco	751	1,073	488	312.5	488.3	244.6	106
New Orleans	241	431	260	177.3	357.7	217.5	NA
St. Louis	310	610	360	241.9	424.6	214.2	97
Denver	473	721	375	237.0	410.5	219.3	95
Baltimore	806	814	470	434.1	434.1	260.1	100
Detroit	357	650	396	194.8	354.3	202.4	100

\* Central County.

\*\* Common Municipal Functions include elementary and secondary education, highways, police, fire sanitation, parks, general control and financial administration.

continued

## SOURCES:

- 1a U.S. Bureau of the Census, "City Government Finances in 1972-73, GF73, No. 4.
- 1b,c U.S. Bureau of the Census, "Local Government Finances in selected Metropolitan Areas and Large Counties 1972-73," GF 73, No. 6.
- 2 U.S. Bureau of the Census, "Local Government Employment in Selected Metropolitan Areas and Large Counties 1974," GE74, No. 3.
- 3 Bureau of Labor Statistics, "Autumn 1974 Urban Family Budgets and Comparative Indexes for Selected Urban Areas." (4-9-75)

Table reproduced from Robert D. Reischauer. "New York City's Fiscal Problem." Congressional Budget Office, October 10, 1975.

TABLE 4

NEW YORK CITY PUBLIC EMPLOYEE AVERAGE SALARIES AND COST OF LIVING COMPARED TO OTHER LARGE CENTRAL CITIES					
CITY	1. PUBLIC EMPLOYEE AVERAGE SALARIES 1974*				COST OF BLS'S INTERMEDIATE FAMILY BUDGET (Index 1974)
	TEACHER	POLICE	FIRE	SANITATION	
New York City	\$17,440	\$14,666	\$16,964	\$15,924	116
Boston	16,726	14,352	13,844	10,666	117
Chicago	20,891	14,146	15,525	11,956	103
Newark	16,464	13,282	13,282	8,473	116
Los Angeles	15,670	15,833	21,180	13,168	98
Philadelphia	15,354	14,354	13,869	13,337	103
San Francisco	15,743	15,529	17,765	13,023	106
New Orleans	10,458	10,746	10,645	4,170	NA
St. Louis	17,545	11,748	13,185	9,593	97
Denver	13,505	12,907	14,198	10,258	95
Baltimore	12,727	10,098	10,980	8,126	100
Detroit	22,603	15,630	16,107	13,814	100

SOURCE: 1 U.S. Bureau of the Census, "Local Government Employment in Selected Metropolitan Areas and Large Counties 1974," GE74, No.3.  
2 Bureaus of Labor Statistics, "Autumn 1974 Urban Family Budgets and Comparative Indexes for Selected Urban Areas," (4-9-75).

\* Figures do not include fringe benefits

Table reproduced from Robert D. Reischauer "New York City's Fiscal Problems." Congressional Budget Office, October 10, 1975.

TABLE 5

NEW YORK CITY'S PER CAPITA  
DEBT OUTSTANDING COMPARED TO  
OTHER LARGE CENTRAL CITIES

CITY	DEBT OUTSTANDING PER CAPITA 1972-1973	
	(a)	(b)
	TOTAL	SHORT-TERM
New York City	\$1,676	\$352
Boston	1,385	334
Chicago	733	169
Newark	616	112
Los Angeles	650	14
Philadelphia	1,015	101
San Francisco	1,225	151
New Orleans	770	39
St. Louis	731	49
Denver	786	52
Baltimore	609	45
Detroit	658	63

\* Central County

Source: U.S. Bureau of the Census, "Local Government Finances in Selected Metropolitan Areas and Large Counties 1972-73," GF 73, No.6.

Table reproduced from Robert D. Reischauer, "New York City's Fiscal Problem." Congressional Budget Office, October 10, 1975.

TABLE 6

THE NEW YORK CITY TAX BURDEN			
FISCAL YEAR	PERSONAL INCOME (\$ BILLIONS)	TAXES* (\$ BILLIONS)	TAXES AS PERCENT OF PERSONAL INCOME
1974-75	50	5.111	10.2
1973-74	48	4.506	9.4
1972-73	45	4.017	8.9
1971-72	43	3.736	8.7
1970-71	41	3.178	7.7
1969-70	39	2.958	7.5
1968-69	37	2.802	7.6
1967-68	34	2.626	7.8
1966-67	31	2.410	7.7
1965-66	29	2.152	7.3
1964-65	28	2.193	7.9
1963-64	27	2.013	7.6

SOURCE: New York City Finance Administration

Table reproduced from Robert D. Reischauer "New York City's Fiscal Problems." Congressional Budget Office, October 10, 1975.

\*Excludes fees and charges, stock transfer taxes and nonresident income taxes.

TABLE 7

NEW YORK CITY'S SHARE OF NATIONAL LONG-TERM AND SHORT-TERM MUNICIPAL DEBT ( AS OF JUNE 1, 1975) (in billions)			
	TOTAL	NEW YORK	% OF TOTAL
LONG-TERM	\$156.7	\$9.4	6
SHORT-TERM	18.3	5.3	29
TOTAL	\$175.0	\$14.7	8+

Source: Robert D. Reischauer. "New York City's Fiscal Problem."  
Congressional Budget Office, October 10, 1975

TABLE 8

CHANGE IN JOBS AND POPULATION IN NEW YORK CITY *						
YEAR	1 TOTAL JOBS (in Thous.)	* INDEX	2 PRIVATE SECTOR JOBS (in Thous.)	* INDEX	3 POPULATION (in Thous.)	* INDEX
1960	3,538.4	94.5	3,130.2	98.4	7,782.0	98.6
1970	3,744.8	100.0	3,182.0	100.0	7,895.6	100.0
1971	3,609.4	96.4	3,040.2	95.5	7,886.6	99.9
1972	3,563.1	95.1	2,998.6	94.2	7,847.1	99.4
1973	3,538.4	94.5	2,964.0	93.1	7,664.4	97.1
1974	3,458.4	92.4	2,877.7	90.4	7,567.1	95.8
1975**	3,375.8	90.1	2,802.6	88.1	NA	NA

SOURCE: 1,2 Bureau of Labor Statistics  
3 Bureau of the Census

Table reproduced from Robert D. Reischauer "New York City's Fiscal Problems." Congressional Budget Office, October 10, 1975.

\* Data Indexed using 1970 as base year

\*\* January - June 1975

## Appendix A

## GOVERNMENT MANDATED COST INCREASES

Over the years, federal and state government by executive, legislative and judicial action have set forth a number of requirements for local government which have had a negative, and often severe impact upon their budgets. While it is not necessary to debate the worthiness of the objectives of many of these regulations, (as we have supported many of them), it is clear that the trend is toward more frequent and costly government regulations with little reform. As the economic status of our nation's cities is analyzed and discussed, the impact of this increased government involvement must be clearly understood. It has mandated upon local government severe inflationary and unplanned expenditures without commensurate revenues to assist in the assumption of this burden. While an exhaustive list has not been compiled, examples follow:

- Government-mandated salaries and fringe benefits:
  - minimum wage
  - Social Security
  - unemployment compensation
  - Workmen's Compensation
  - old age survivors and disability insurance
  - hospital insurance
- Compliance with the Davis-Bacon Act - - minimum rates for all federally-assisted construction
- Compliance with 13(c) labor requirements for mass transit monies

- Compliance with the Occupational Safety and Health Act
- Impact of the Brooke Amendment on Public Housing
- Necessity for filing impact statements on both environmental and national historical effects of federally-assisted projects (this has been further mandated by states and courts to include most projects regardless of funding source)
- The need to meet the ever-increasing demands and requirements of the Equal Employment Opportunity Commission
- Community participation requirements
- Since the time of the rash of air hijackings, the requirement for increased airport security, with no commensurate airport tax for revenue
- Federal matching requirements in order to obtain federal monies (it is proven that the 20 percent or less requirement, when indirect match is eligible, merely places a paperwork, administrative juggling burden upon local government - - no actual dollars are utilized), and
- Achievement and maintenance of environmental standards for air, water and noise quality.

Again, this list is not exhaustive but merely represents the tip of an ever-surfacing iceberg. Furthermore, this list does not accurately reflect one of the most significant causes of direct mandated costs and additional need for man-hours -- the growing and always under-standardized and changing paperwork burden. In his recently published book Government-Mandated Price Increases: A Neglected Aspect of Inflation, Murray L. Weidenbaum devotes several pages to the aspect as it relates

to the private sector. A particularly noteworthy point is that the U.S. Office of Management and Budget estimates that the reporting burden imposed on American business by the federal government increased to 50 percent between December 1967 and June 1974. While comparable data does not exist for the public sector, the principal source of the increase; namely, new programs such as occupational safety and health activities, Medicare and Medicaid, environmental protection regulations and equal employment opportunity compliance - - is also directly applicable to the public sector.

On a specific example found in the above list, Mr. Weidenbaum<sup>1</sup> cites the impact of the Davis-Bacon Act on the public sector.

"Extensive studies by the General Accounting Office have shown that the Davis-Bacon Act adds from 5 to 15 percent to the cost of federal construction. During a brief period in 1971 when the President suspended the Davis-Bacon Act, several construction contracts were awarded which provide comparative data on costs with and without the influence of this piece of federal regulation.

- On a contract to install government-supplied generators in a veterans hospital, the first low bid, using the 'pre-vailing' wage determination procedure of Davis-Bacon, was \$28,884. After the suspension of Davis-Bacon, the contract was rebid. The new low bid, submitted by the original low bidder, was \$22,769. The work was completed at this price for a 22 percent saving.
- A federally assisted hospital being built in the northeast United States let a contract during the suspension period for one phase of the construction. The work was completed at a 23 percent saving over the cost of a similar, earlier phase which had been subject to Davis-Bacon requirements.
- In Florida, a contractor submitted two bids for the same work on a public housing project, the higher one under the Davis-Bacon procedure and the lower one without the restriction. The difference was \$18,000--of 6 percent saving.
- In the Midwest, an electrical company was awarded two separate contracts for similar-sized phases of work on a college building being built with federal support. The phase that was not subject to Davis-Bacon cost 10 percent less than the phase that was."

1

Murray L. Weidenbaum, Government-Mandated Price Increases (Washington, D.C.: American Enterprise Institute for Public Policy Research, 1975), pp. 62-63.

Lastly, the National Commission on Water Quality has estimated that the cost to state and local governments to attain and maintain water quality standards over the next twenty years will be roughly \$305.5 billion in 1975 dollar values. Furthermore, the cost to taxpayers to achieve standards in the carbon monoxide laden regions of the country are estimated at \$2 billion through 1979. About half of this will be for retrofit equipment and half will be accumulated costs of inspection and maintenance programs and service-station vapor controls. All of these costs must be borne by our nation's residents.

## Appendix B

## MEASURES TAKEN BY NEW YORK CITY TO REDUCE CITY EXPENDITURES\*

Mass Transit

- City has raised transit fare overall from \$.35 to \$.50 -- an increase of approximately 43%.
- Fares for the elderly raised from \$.35 to \$.50 for round-trip. Fares for school children stayed at \$.35 for round-trip.

NOTE: New York City Transit Authority's budget is apart from the city's, but it is heavily subsidized by the city. The additional revenue which will be obtained by the increased revenues (approximately \$110 million) will go towards the transit budget and not New York City's.

Education

- City tax levy funds for the City University have been cut \$32 million by the Mayor. An additional \$32 million reduction takes place from State funds because the aid program has a matching requirement.
- The Board of Higher Education has voted to retain a free tuition policy. Cuts will probably come in staff and other services.

Personnel Layoffs

- As of the end of September 1975, 22,000 City employees were off the payroll due to layoffs. Over 9,000 additional jobs were trimmed through retirement, turnover, etc.
- The 22,000 layoff has realized a \$400 million savings.

Wage Freeze

- Wage freeze instituted for all employees. This will realize a \$100 million savings for this fiscal year.

Capital Construction Freeze

- There is a total capital construction freeze.

Realigning of Capital and Operating Budgets

- Items appearing in capital budget appropriations for operating expenses are being shifted back to the regular operating budget. To date, \$30 million has been shifted.

Reorganization of City Agencies

- There is under way, a major reorganization of City agencies including dismantling of the so-called "super" administrations, and in some cases, the elimination of entire departments.
- This reorganization is to realize a \$4.8 million savings.

Other Measures Taken

- A firm commitment to a ceiling on expenditures with no increases in taxes.
- A new Mayor's Management Board has been established to recommend changes in the City's administrative process and to develop greater productivity. The Board is composed of major corporate executives and chaired by Richard Shinn, President of Metropoli.
- A Temporary Commission on Long Term Financing has been established by the Mayor, composed of leading experts in urban policy and financing, to develop methods of financing for the City in the future.
- A new accumulating system is being implemented to conform to the State controller's manual.
- A new Deputy Mayor for Fiscal Affairs has been appointed by the Mayor. Ken Axelson, Vice-President of J.C. Penney has joined the City to develop the fiscal plan presented on October 15, 1975 to the Emergency Financial Control Board. He is to be in charge of all fiscal matters for the Mayor.

\* This list does not include measures detailed in the October 15, 1975 fiscal plan submitted to the Emergency Financial Control Board.



October 17, 1975

The Honorable William Proxmire  
Chairman, Committee on Banking,  
Housing and Urban Affairs  
5300 Dirksen Senate Office Building  
Washington, D.C. 20510

Dear Mr. Chairman:

On behalf of the Board of Directors of the National League of Cities, I wish to urge your Committee to act favorably on legislation to provide emergency credit assistance to New York City. We believe that the city and state of New York have exhausted their resources and authority in attempting to prevent financial disaster and that the federal government must now act. Inaction on the part of the federal government will have devastating consequences well beyond the borders of the city and state of New York. We believe that a national crisis exists--a crisis that could critically disrupt the capital financing of every governmental body in the country--a crisis that is likely to plunge the country back into another economic recession.

Under the By-laws of the National League of Cities, the Board of Directors is empowered to establish organizational policy for the nearly 15,000 municipal governments which we represent here in Washington. The Board's policy position regarding the role of the federal government in the New York crisis was developed only after the most careful consideration by our policy committee which has jurisdiction over fiscal and economic affairs. This committee, which is known as the Effective Government Committee and is chaired by Councilwoman Jessie Rattley of Newport News, Virginia, spent many, many hours deliberating on the New York crisis. During its meeting, members of the committee became convinced that a default on New York City bonds would have a significant effect on the entire municipal bond market, causing interest rates to rise and driving potential investors out of the municipal bond market altogether. They argued that a default on New

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Mayor, Kansas City, Missouri

Ronald F. Williamson  
Executive Director  
South Dakota Municipal League

Wes Wise  
Mayor, Dallas, Texas

J. McDonald Wray  
Executive Vice President  
Municipal Association of South Carolina

The Honorable William Proxmire  
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York City bonds must be prevented. Therefore, they recommended the following policy statement for consideration by the NLC Board of Directors:

"Congress and the Administration should be prepared to assist a municipality to obtain needed credit during a financial emergency only if it is apparent that the municipality and its state government have exhausted all constitutional, legal and fiscal remedies available under their respective authorities. Assistance measures which may be appropriate in a financial emergency, should not be made a permanent feature of federal policy with regard to municipal bond financing."

As the second sentence of this statement indicates, the committee was opposed to any across-the-board permanent federal involvement in the municipal bond market. To make the point absolutely clear, the committee also proposed the following:

"In addition, municipal governments oppose a continuing system of federal government guarantees of insurance of tax-exempt or taxable municipal bonds."

Simply put, our Effective Government Committee recommended to the NLC Board of Directors that the federal government should be prepared to provide necessary credit assistance to a city facing a financial emergency, if the city and its state government have exhausted their resources and authority available to them.

This proposed policy statement was then forwarded to the Board of Directors of the League for their consideration. A majority of the members of the Board have since submitted ballots approving this policy, and it is thereby the official position of the National League of Cities.

The development of our policy position was not a knee-jerk reaction to a crisis situation. This policy has been carefully developed and ratified by a Board of Directors that is representative of the diverse interests of municipal governments throughout our country. I call your attention to the right hand side of the first page where our Board members are listed.

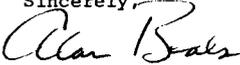
The recent actions taken by the City of New York to reduce its deficit by \$200 million, and the continuing commitment of the state government, should be evidence that both the city and the state are doing everything that their resources and authority permit to prevent financial collapse of the city. It is now time for the federal

The Honorable William Proxmire  
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government to recognize that the crisis is a national one and that federal involvement is imperative. We believe that S. 2514 and S. 2523, both of which would enable the city to issue federally-guaranteed taxable bonds, are sound approaches to this emergency. They are not bail-outs. Instead, they would provide the necessary federal credit assistance and federal safeguards to insure the financial stability of New York City.

On behalf of the National League of Cities, I urge your Committee to favorably consider such legislation.

Sincerely,



Alan Beals  
Executive Vice President

The CHAIRMAN. Mr. Mulroy.

Mr. MULROY. Mr. Chairman, members of the committee, NACo thanks you for this opportunity to appear today. I am John Mulroy, county executive of Onondaga County, Syracuse, N. Y. I am here today representing the National Association of Counties on whose board of directors I serve. Yesterday, the board approved a resolution which calls for an emergency Federal guarantee of taxable bonds issued by a municipality which has exhausted all other constitutional, legal and fiscal remedies to obtain credit. Mr. Chairman, this vote was taken across this country and it came out 53 to 3 in favor of the resolution.

The CHAIRMAN. Who did this vote represent?

Mr. MULROY. The board of directors of the National Association of Counties which is broadly representative both geographically and politically of the 3,101 counties in our country.

As the elected county executive of Onondaga County, whose population is 475,000 people, I can speak with personal knowledge of the impact that the New York City situation has had on other local governments like mine which has an AAA bond rating and is in a relatively good financial position. Our's is one of only 28 AAA bond rated counties in the Nation. Default and the fear of it by New York City and State is having a profound effect on the municipal bond market as well as the Nation's overall economy.

Reflecting this uncertainty, the municipal bond market is in disarray. Interest rates paid on municipal bonds are soaring in many parts of the country. Fairfax County, Va., for example, floated \$2.9 million in school bonds at 7 percent interest, up from 6 percent last March, costing over \$290,000 in interest over 20 years. The State of Connecticut sold \$100 million in State bonds at 6.1 percent interest in early September, up from the 5.6 percent interest on a June sale. The additional cost is \$1.7 million. The city of Buffalo, N. Y., paid double the interest (10.5 percent) in \$6 million in short-term notes in September over last spring. An additional \$18 million could not be sold by that city for lack of a bidder.

We do not feel that citizens in other jurisdictions should be forced to pay higher interest rates because of New York City's financial problems. In my county last week, we borrowed \$9.8 million at an average of 7.9 percent, which is 2 percent higher than any recent loans. In February, we borrowed money at 3½ percent interest. We New York county officials can understand part of the finance problem faced by New York City because in our State the counties and New York City—which includes five counties—are responsible for the administration and partial funding of social services programs. In my county over 40 percent of our budget is directed to meeting the needed human service requirements of our residents. Social services in 1975 account for nearly 50 percent of the total appropriations for New York counties. New York City's budget problems in the welfare area are a magnification of those faced by counties in the State.

I would like to read you the resolution which the National Association of Counties Board approved yesterday:

"The National Association of Counties views with deep concern the present financial situation of New York City and New York State, and resulting effect which their financial crisis is having on the municipal bond market. In no way does NACo excuse or otherwise approve of

the city's unsound financial practices nor endorse the practices of labor or the financial community which have also contributed to the crisis—questionable accounting procedures to disguise deficits, financing certain operating expenses from the capital budget and other questionable practices. Recognizing, however, that in the absence of emergency Federal assistance New York City, and very likely New York State as well, will default causing serious damage to the municipal bond market and to the Nation's economy, NACo believes that if the Congress and the administration should make emergency assistance available to States and localities, then assistance should be made under the following conditions:

1. That the assistance be in the form of a Federal guarantee for the issuance of a taxable municipal bond for a limited period of time and upon payment of a fee; there should be no Federal underwriting of bond issuance costs;

2. That it be available only to those States or units of local government which have exhausted all constitutional, legal and fiscal remedies to obtain credit and are unable to do so;

3. That, in the case of a unit of local government, the State has assumed control and responsibility of the unit's finances during the period of guarantee.

4. That evidence be shown that the indebtedness arising from federally guaranteed bonds can be repaid as rapidly as is consistent with the continued provision of vital government service; and that specified revenues should be earmarked for repayment of the guaranteed debt.

5. That a jurisdiction utilizing the Federal guarantee be required to achieve a balanced budget within a fixed period of time.

Federal assistance made available under these conditions must be restricted only to those extraordinary situations where the only alternative is default."

I would like to briefly elaborate on why we feel these conditions are necessary. We believe that the issuance must be taxable so that the burden of New York City will be lifted from the tax-exempt market to help all other local governments which are part of that market. We believe that governments which have permitted themselves to drift into such dire straits must pay the price of higher rates for taxable bonds.

NACo feels that the States have an important role to play in maintaining the solvency of their cities and counties, and no jurisdiction should be eligible to apply for a Federal guarantee unless the State has also exhausted all of its remedies to assist the government.

I would like to emphasize our insistence that any jurisdiction that seeks a Federal guarantee must earmark specific revenues to repay the guaranteed debt. We also insist a jurisdiction be required to have a balanced budget within a fixed time period.

We do not condone bad financial management by New York City, or any other jurisdiction, but we do feel the Congress must act swiftly to protect citizens in other cities and counties from being forced to pay higher interest rates because of the New York crisis.

Thank you, Mr. Chairman.

[Complete statement of Mr. Mulroy follows:]

TESTIMONY OF JOHN MULROY BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING  
AND URBAN AFFAIRS ON OCTOBER 16, 1975.

Mr. Chairman and Members of the Committee:

I am John Mulroy, County Executive of Onondaga County (Syracuse) New York. I am here today representing the National Association of Counties (NACo) on whose Board of Directors I serve. Yesterday, the NACo Board approved a resolution which calls for an emergency federal guarantee of taxable bonds issued by a municipality which has exhausted all other constitutional, legal and fiscal remedies to obtain credit.

As the elected county executive of Onondaga County, whose population is 475,000 people, I can speak with personal knowledge of the impact that the New York City situation has had on other local governments like mine which has a AAA bond rating and is in a relatively good financial position. Our's is one of only 28 AAA rated counties in the nation. Default and the fear of it, by New York City and State is having a profound effect on the municipal bond market as well as the Nation's overall economy.

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NACo feels that the states have an important role to play in maintaining the solvency of their cities and counties, and no jurisdiction should be eligible to apply for a federal guarantee unless the state has also exhausted all of its remedies to assist the government.

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We do not condone bad financial management by New York City, or any other jurisdiction, but we do feel the Congress must act swiftly to protect citizens in other cities and counties from being forced to pay higher interest rates because of the New York crisis.

The CHAIRMAN. Mr. Mulroy, thank you very much for a fine, eloquent statement, and I might say to the mayors of New Orleans and New York, Mayor Landrieu, your nickname I understand is Moon, and we all know, of course, that your colleague on your right is Mayor Beame, and it's been said that they might have a "moonbeam" ticket this year for the Presidency. Well, the enlightenment you have given us this morning has suggested that that's more than just a joke.

You gentlemen have given us an extremely persuasive and eloquent statement concerning your viewpoint.

Mayor BEAME. Senator, I can think of no better running mate.

The CHAIRMAN. Mayor Beame, some have argued that a default for New York City would not be such a disaster as others fear. You're the mayor of the city. You have been an official of New York City for many, many years. I think that you can speak with great authority on the effect of a default.

Yesterday we seemed to be on the brink of a default. As you know, the comptroller was reported at least to have directed the sanitation department to stop distributing paychecks and as I understand it, a State supreme court justice requested the city to ratify priorities of vital services heading the list and city payrolls taking precedence over payments to holders of debt.

Now this suggests that in the event of a New York City default which may come in December unless we can provide the Federal assistance, some city employees will not be paid and an indeterminate number of city note holders and bond holders wouldn't be paid.

Now recognizing that nobody has been through this, it's extremely hard to make any kind of—give any kind of firm assurance on this. Tell us what is likely to happen in your city as you see it if the city defaults. I want to know how deep a cut would be necessary in services to permit your cash income to cover your outgo and that is what would it require? A shutdown of your schools? Would it require a layoff of 25 percent of your police, 50 percent of your sanitation workers, close half your hospitals, end your parks and recreation system? What would happen?

Mayor BEAME. Our cash needs after December until June 30 is approximately \$4 billion, about \$3.5 billion for debt and a net of \$400 million or thereabouts to meet expenditures—operating expenditures. However, we have a cash flow problem where in the last 3 months of the year we run at a surplus but in the prior months at a deficit, so that after December we will be shy not alone the amount to pay the debt but in the first 4 months thereafter, from December through March, we would be shy more than \$1 billion to pay our operating costs.

That would mean that we could not meet salaries or needs of food for our welfare people would not be able to be paid for to the extent of \$1 billion, until we got some money a little later on, as I said, in the last 3 months, where we would run a surplus.

The CHAIRMAN. What does this priority list mean? As I understand it, the Supreme Court Justice issuing a writ indicated payrolls would take precedence over payments to note holders. Does that mean that you would, as you explain it to me now, you would not be able to meet some of your payroll in spite of that; is that correct?

Mayor BEAME. Exactly. As a matter of fact, Senator, the city has been preparing for a long time in case we run into problems, and I had set up a contingency committee of some outstanding people in our city and also retained the services of a well known law firm. By the way, the senior partner of which is sitting to my right, Mr. Millstein; and Mr. Axelson, who is the deputy mayor.

After their meetings and their judgments, we set up an order of priority that we would have to meet in order that we keep the city going. Because, if the city doesn't operate there would be nothing for anybody.

The CHAIRMAN. As you know, Mayor, whether this gets through or not is a close thing, particularly with the opposition of the administration, and I think it would be very helpful to us in making this judgment if you could tell us just as definitely as possible, for instance, will the schools be closed? Might they have to be closed?

Mayor BEAME. Undoubtedly, there are going to have to be tremendous cuts in the school area and how they would work it out would be their responsibility. It would obviously affect the schools services in the sense that it might lead to some closing. That would be their judgment.

It would lead to thousands of additional employees be layed off, over the thousands of reductions we now are already planning within the cuts I announced the other day, which by the way is over the 31,000 that have been separated since January 1.

The CHAIRMAN. Now Governor Carey—

Mayor BEAME. As to exact numbers, I don't have them; but I would be very happy to provide information as to the effect of a billion dollar cut in 4 months.

The CHAIRMAN. We would appreciate it.

Governor Carey indicated that it might be necessary to call in Federal troops under these circumstances. Do you foresee that this is a possibility?

Mayor BEAME. All that I say in that regard is that we have been fortunate. Despite the tremendous cuts of services affecting the poor, affecting the employees, we have received fine cooperation from both the leaders of the labor movement as well as from the people. I know that we are going to get great expressions of dissatisfaction, and to what extent the disorder could occur, I don't know. Certainly, if disorder does occur we will need more than the help of our own security forces.

The CHAIRMAN. At any rate, this cut you estimate would be about—this reduction in operating payroll would be around a billion dollars; is that correct, on an annual basis?

Mayor BEAME. That would not only be payroll, Senator. It would also involve, as I indicated, payments to the poor who are on welfare. It would involve food, clothing, and medical care and hospitals, and our jails, and so on.

The CHAIRMAN. Why couldn't the State of New York provide this assistance? It was suggested to me yesterday by a very competent official in the administration that New York could impose an additional sales tax, not on the city—he agreed the city was too heavily taxed now and it could be counterproductive to increase taxes further—but the State has the fundamental responsibility here. Why couldn't

the State increase its State sales tax by 2 percent and provide you with a billion dollars you need?

Mayor BEAME. Aside from the fact that, as has already been indicated by Standard & Poor's, if the State went much further than what it did, it would affect its own fiscal integrity. Aside from that fact, I want to express a very practical observation that we have got as much chance of getting a sales tax upon the people of the State for the benefit of the city as a snowball in hell. Because as you know, we have a divided legislature and the Republican Party in that regard would not do anything to help the city of New York by taxing people outside of the city to help New York City.

But I do want to say that the State has taken many very, very significant steps to help us and—I refer again to the fact that the Standard & Poor's have indicated that it would affect their own fiscal integrity if they went much further.

By the way, one other observation, if I might, Senator, I know that when Lockheed and Penn Central were helped their stockholders weren't asked to ante up anything. There's no reason why the people of the city and the State of New York ought to be asked in order to get this guarantee.

The CHAIRMAN. I'm not sure that that's a very good precedent. I strongly opposed both of those actions and I'm very sympathetic to yours, although I haven't taken a firm position.

Mayor BEAME. Thank you.

The CHAIRMAN. Let me ask this. One way of solving this problem is that from the city's own standpoint, from the standpoint of the city administration and from the standpoint of the citizens, default is argued to be a more advantageous route because then the bulk of the cuts could and should come by a debt moratorium or rescheduling of principle, if not interest. Why not follow that route?

Mayor BEAME. I think everybody would agree that if default occurred and we had to follow that route, that New York City couldn't find its way into the capital markets for many, many years. Therefore, we would not be able to get the cash to be able to meet our needs. Default is purely going to be a temporary solution if we then rearrange our priorities to avoid the payment of debt. That won't help us to live in the long term.

The CHAIRMAN. It's true, of course, Mayor, that New York has never defaulted and a city its size has never defaulted in this country. However, Detroit did default and was back in the market able to raise funds within a reasonable period of time. Why do you think that this would mean that New York couldn't follow the same course if it straightened out its operations and it balanced its budget and so forth?

Mayor BEAME. All that I can say is that this kind of an expression of opinion has been evidenced by people in the financial market and in terms of any other city where the needs are so small by comparison, I can understand that. For example, when I went to see the President, along with Moon Landrieu and the other mayors, he indicated, well, Grand Rapids defaulted and came back. I don't know. I should have taken the time to look up the debt that they defaulted on and probably it may have been comparable to a week's debt of New York or less. It wouldn't have that kind of effect and, above all, the default is certainly an avenue that I don't think responsible government should look for.

The CHAIRMAN. My time is up. Mayor Landrieu wanted to comment and then I'll yield to Senator Brooke.

Mayor LANDRIEU. Senator, I think that we would be strongly opposed to a suggestion that bankruptcy come first. I know there's been some suggestion from the administration that the way to really cure this problem is to go in and alter the bankruptcy laws and then let New York go bankrupt and reorganize its debt.

Our feeling at this point is that to make it easy for a city to go bankrupt is going to eventually cost all of us staggering millions of dollars. Bonds that we issue are intended to be covenant contracts. The person lending the city money expects to get paid back and not to have the bankruptcy laws altered post facto thereby making it easy for cities to go into bankruptcy.

Now if you do that with New York City, then every bondholder or prospective bondholder of any municipal out there has got to ask himself, "Will it happen to me? If this city gets into a little financial difficulty, will it be a simple course for it to file bankruptcy, in which case I won't get my money?" And I can assure you, and you know it better than I do, that's going to reflect itself on the market rates that are to be paid.

Mayor BEAME. Senator, I may have misunderstood a question you asked on the amount of money we'd be short in order to operate. When I indicated \$1 billion, that would have been only for the 4 months following December. But if you annualize that, it would be equivalent to \$3 billion a year which would probably be at least half our whole payroll and would obviously be very damaging.

The CHAIRMAN. But you would get that back. It cycles back over the full year, doesn't it? It's the 3-month cash flow problem that's your problem.

Mayor BEAME. Yes, but if we were going to lay people off to get a billion, we would have to lay off the equivalent number of people to get an annual benefit. I also want to make the observation that we have already, in our cuts of what we did this year and what we're planning to do, we are saving the Federal Government almost \$130 million by reason of the fact that our cuts affect matching of Federal funds. So that, in a sense, we are helping the Federal Government balance out their \$80 billion deficit.

The CHAIRMAN. My time is up. Would you identify the gentlemen on your right again for the record?

Mayor BEAME. Deputy Mayor of Finance Kenneth Axelson, and Ira Millstein, who is the senior partner in Weil, Gotshal & Manges, attorneys.

The CHAIRMAN. Very good.

Senator BROOKE. Mr. Mayor, prior to becoming mayor of the city of New York, you were a long-time comptroller of that city. You must have seen this crisis building over a period of years.

When you ran for the office of mayor, how did you expect to deal with the problem?

Mayor BEAME. That's a good question. I have already made a few observations, but I want to make some more with respect to that. I have not shirked my blame for responsibility in this. However, I do think you should know that the functions of the comptroller are functions of criticism and not power or action. The comptroller has no in-

put into the policies, the fiscal policies of a city. Those are made by the mayor and the mayor alone, and if you would like to get—I'd be very happy to give you and I have here a list of dozens and dozens of criticisms that I made to the administration during the time that I was comptroller with respect to their fiscal policies; just like the present comptroller may be criticizing me, but he has no input into the fiscal policies.

The budget, which is adopted and has been adopted, was prepared by the mayor, prepared by me in these last 2 years, and there wasn't one change made with respect to the comptroller's observations, not one change which was voted upon that way.

So that I must reemphasize that the comptroller's basic position and basic responsibility vis-a-vis the fiscal policy—basic power I should say, is criticism. Of course, he has other duties, but I'm speaking with respect to the fiscal policies.

Senator BROOKE. But you had the knowledge of it when you ran for the office of mayor, even though you had no control over it prior to that time. You certainly must have known. It's inconceivable to me that the investors, the bondholders, and the public officials of New York didn't know that this crisis was building. Now we are being subjected to what I call stampede psychology. We are trying to rush this thing through the committee, through the Senate, and through the Congress, and this is not something that just happened overnight. This is something that must have been building for a period of years and you had knowledge of that prior to running for the office of mayor.

My question is: First why did you run for mayor if you knew it, and second, how did you intend to deal with this problem? Did you intend to have the Federal Government bail you out?

Mayor BEAME. All during the time that I was comptroller we had no problem in terms of entering the market and getting credit. During the first year and 3 months of my term which began January 1, we had no trouble getting credit from the financial community.

Senator BROOKE. But the administration had been guilty of very questionable management procedures and certainly the bondholders must have known what your rollovers were and what had been going on in New York for a long period of time. Didn't you and they know that the bubblehead would burst at some point?

Mayor BEAME. The financial community and we were well aware of these rollovers and every issue, as you know, had to be approved by the banks' bond counsel, so that there was nothing which was being held back.

Senator BROOKE. But you had the greatest financiers in the country, perhaps in the world, in the city of New York. You said so yourself and we know it to be true. How did this happen? How did you let it come about?

Mayor BEAME. I didn't let it come about. I inherited a good deal when I walked in. I came in at the time there was a \$1.5 billion deficit. Then along came the national recession which hurt us to the extent of about half a billion, and I began to cut our budget back in November of 1974 when this situation first began to hit us. In this current budget, as I indicated, we were cutting back as much as we could in order to get access to the markets again.

Senator BROOKE. All right. If you go into default and the Federal Government does not provide a guarantee, what procedure would be followed by the city of New York as far as its creditors are concerned under the New York State Financial Emergency Act of 1975? Would the city's creditors eventually be paid?

Mayor BEAME. Under that law, the priority is given to the holders of notes and bonds and then to the use for operating expenses. Now what we did the other day and we are prepared to do is to change that priority by filing a petition so that we can keep the city running. In order that we should have cash and the provisions in the State law, the emergency control finance board law, would have been reversed by court action.

I hope you will allow Mr. Millstein, who is our attorney, to expand on that.

Mr. MILLSTEIN. Senator, just very briefly, I think your question was what would happen under the existing State law, and the answer is that all debts and obligations would have to be provided for in any composition under the existing State law.

Senator BROOKE. So the creditors would be paid in full?

Mr. MILLSTEIN. Eventually. You would go to court. You would seek a stay, try to postpone your debts and obligations long enough to raise money in the market, and so on.

Senator BROOKE. But you have about 90 days before anything would happen?

Mr. MILLSTEIN. You have an initial 90-day stay in which everything freezes—debts, obligations, and so on—and during that period any extensions that the court might grant, you come in and try to work out some long-range plan to pay off your debts. However, that presupposes getting money again some place in the interim and that is something that's not provided for in this law. The State law also doesn't provide for any means of adjusting any debts. In other words, honoring its contracts or other things like that, from which you might want to seek relief in the courts—the State law gives you no such ability. You take the obligations as you find them and schedule them out for payment and hope that you can raise money in the interim to keep the city afloat.

Senator BROOKE. Now if New York City default, is it not possible for you to cease paying your creditors, thereby freeing up funds to pay your employees? On an annual basis, you would have no problem paying your employees. However, between now and April you would be likely to have the problem of meeting payrolls. I think that's what you said, Mr. Mayor.

Mayor BEAME. We'd have a problem meeting it right after December 1.

Senator BROOKE. Now could this short-term cash flow not be met by a one-time short-term loan from the Federal Reserve Board to be retired by taxes coming due in the spring? Have you considered that as a possibility?

Mayor BEAME. Well, at this point we haven't gotten any encouragement from anybody on the Federal level except—

Senator BROOKE. That could be authorized by the Congress—we could authorize the Federal Reserve Board to do this.

Mayor BEAME. It would only be a short-term solution. We'd be faced with the same problem thereafter because we would have a similar problem in the following year in order to be able to meet our cash flow.

Now you can't have any business, let alone a Government, shut-off from the ability to borrow against certain revenues which are not coming in at the time that you need them. We have that in a business operation as well where they borrow against their accounts receivable.

Mr. Axelson has something he would like to add to that.

Mr. AXELSON. Senator, with respect to your specific question whether if debts service were suspended, would there be sufficient funds out of the city revenues for paying payrolls and essential vendor services, the answer is that over the next 2 years, no, there would not be. The city's financial plan which has been submitted to the Emergency Financial Control Board provides, as you know, for a balanced budget, in the third year. However, I would point out to you that that's a balanced expense budget and does not provide for the funds that are necessary for capital construction.

Now a city like New York cannot just shut off capital construction completely. We have taken steps to very substantially reduce the commitments under our capital construction program, but even though we have put a stop on every single contract that does not presently represent a legally binding commitment, we still are left with \$1.7 billion of construction this year, \$1.2 billion next, and \$1 billion the following year, just to carry out existing undertakings. So those funds, in addition to the expense budget, will have to be financed.

Senator BROOKE. All right. Thank you very much. Unfortunately, my time is up. I'll be back on the second round of questions.

The CHAIRMAN. Senator McIntyre.

Senator MCINTYRE. Thank you, Mr. Chairman.

Well, gentlemen, some of the facts that stick in my mind are that no other major city is in such financial plight as New York. New York appears to be a victim of social movements of the last 10 or 20 years in and out. I agree New York is special. The cities and counties dread the rippling and aggravating effect on the bond market. That's probably its strongest argument on the floor.

Secretary Simon, however, says the effect of default by New York City would be temporary and tolerable. Secretary Simon also states that discipline of the marketplace is important to our Nation's cities and towns in the present and in the future.

So the question to me that's bugging me is why does the Congress have to act so as to avert default? I'm told that yesterday the city was within an hour of default. The Nation wasn't trembling. The city wasn't in chaos. I wonder who are we being asked—who is the Congress being asked to help? The private investors, the bondholders, the wealthy doctors, lawyers, merchants, Senators? Where are they all playing? They are all playing in the tax-exempt market. I have to ask myself because it is a tough problem, as the chairman stated initially at the beginning, I have to ask myself as a Senator, is it a better course—are we better advised to allow default to occur?

Then, without need to pay this existing bonded debt of some \$3.5 billion, it would seem to me that default would free up sufficient

moneys, maybe with further curtailments on the payroll, on the teachers, on the policemen, on the firemen, and then I think if you had to have additional help if you had to have additional help at that time to get through there would be an entirely different question that you might be posing here a year from now or 6 months from now to the Congress.

Why isn't that the better solution? Why don't we take our medicine from the discipline of the marketplace—and Secretary Simon is a very wise man in many respects. His advice to us is good.

On the other hand, I'm concerned with New York City and what will happen because all the testimony—nobody will come down hard and—they are only going to speculate. Why isn't this the better course? The mayor of New Orleans and the witness for the counties, why isn't this a better course to take our medicine? Why wouldn't you be better off in the marketplace a year hence if the discipline is exerted instead of the Government moving in to bail out or help out to get them over the rough spot?

Mayor LANDRIEU. Let me try to respond, Senator. No one really knows. I think Mr. Simon said that and many other experts. We are all in a sense trying to give the best educated guesses that we can.

First of all, from the standpoint of other cities, New York City's default is going to cast a pall on the market across the United States. This is our honest belief. This is what our bond council is telling us. This is what the market is currently reflecting.

No. 2, to permit New York City to go bankrupt and then to step in is going to be more costly. I can assure you that the Federal Government will intervene, if not before, then after bankruptcy. It isn't simply a question of defaulting temporarily on some outstanding bonds and notes. There are operating deficits that have to be met in that city and can only be met through borrowing.

Irrespective of the current good nature of the public employees in that city, I don't know that you could fairly expect the public employees—police, firemen, sanitation workers and health workers—to continue to work without being paid. Now it's anybody's guess as to what happens if in fact the public employees are not paid. I suggest to you also that the city is not a monolithic kind of political structure that any mayor can alter overnight. There are innumerable boards and commissions. There are labor contracts outstanding. There are pension benefits.

In some instances, it costs more money to lay off an employee—this is true in the private sector, too—abruptly than it does to phase it out. So you force counterproductive measures in that kind of procedure.

It seems to me a relatively simple solution to guarantee a loan and to avoid the kind of catastrophe that could conceivably exist.

The only argument I have heard against that has been one that's been philosophical. We do not want to interfere in the traditional city-State relationship. Well, I wish Congress and the administration would think of that when you pass EPA laws and minimum wage bills and countless other laws that affect the Nation's cities and pass on the bill for us to pay. Somehow or other that principle gets lost when those matters are being considered by Congress. But it seems to me that we don't have to test that risk; that it's a simple solution that is being afforded that helps all these things in the country. It doesn't cost

the taxpayers of the United States anything and it gives New York the necessary time to work its way out of its current bind. Perhaps someone else wishes to play roulette with the economic future of this country and particularly with the lives of 8 million in New York and the lives of the people in my city. I don't think that's a risk worth taking.

Mayor BEAME. May I also say, Senator, that there is a strong weight of opinion contrary to Secretary Simon, as you have undoubtedly read and heard. That weight of opinion has even spread to the international scene where we have found in observations from foreign ministers that, in their judgment, such a situation of default would have its effect on the international picture.

Mr. MULROY. Sir, I'd like to bring one other point to the fore at this time considering the default of any municipal bonds. As you know, during the sixties, many, many hundreds of people—hundreds of thousands of people who were never involved in the stock market became involved in the stock market. The tradings on the New York Exchange doubled in that period of time. In the early seventies, 1972 and 1973, the stock market wasn't such a good idea. Many of them found out and they got burned and they got out. Since then, many of these people—and for the moment—I don't like to use this term, but we'll call them little people, as separate from doctors, lawyers, and wealthy men and Senators—have invested in municipal holdings. We in Onondaga County issue approximately \$20 million a year in bonds and many of them in small denominations—that is, \$5,000 and \$10,000, and many people who have a little surplus of money will invest in these types of things.

Since this crisis in New York City has been evident, I have had dozens of people, who I never realized had any surplus money come to me and say, "What is going to happen? I own UDC bonds or I own a few New York City bonds or I bought some big MAC's." There are hundreds of thousands of people in this country who have invested \$10,000 or less in these types of municipal bonds. Default by the city of East Podunk is one thing, but a default in the city of New York is something else, and I think it would have a disastrous effect on the sale of bonds in other cities and other counties.

Mayor BEAME. I would ask Mr. Millstein to just add to that.

Mr. MILLSTEIN. Senator McIntyre, there is one aspect of this—I'm not going to talk to the rippling effect on bonds or the security markets, but having watched and participated in the entire city administration stay up for 48 hours as a city facing default situation, the total uncertainty involved when a city of the size of New York faces default, not in terms of world markets or not in terms of what's going to happen to bonds next year, but what's going to happen the day of default. Nobody has ever defaulted before in this dimension, of this size. This is not a big business going into default or a small business going into default. This is the city of New York going into default and there are a host of relationships which have existed between creditors and debtors and sellers and vendors to the city that have just existed for dozens and dozens of years because they exist.

Now when you go into default all of those relationships become open to question for the first time. Bank accounts can be attached. Setoffs can be claimed. Money that the city thought that it had ready to pay

checks with might be grabbed by attachment or otherwise by somebody else. Welfare checks begin bouncing.

With all the planning in the world and with all the foresight in the world, since there's no form book to go to see what happens when a municipality the size of New York defaults, there isn't anybody who can tell you what happens the next day on the streets. Will the garbage men stay in the trucks—I don't know—if those checks are stopped? There were rumors yesterday that possibly they might not. Will the banks honor bank accounts or setoffs? I don't know. Nobody knows exactly what's going to happen until they are faced with that possibility. Will litigation begin as between various holders of securities contesting each other as to who has priority? Nobody knows because this never happened before.

I could give you quite a list of the uncertainties that we face and how we tried to cope with them, but I don't think there's anybody in the United States who can tell you what it is going to be like the next day. We could only guess and there isn't any way to know.

There was a form of uncertainty in my judgment which transcended the uncertainty about the bond market or anything else; that uncertainty was about the citizens of New York and what was going to happen to them in the ensuing days, and there isn't anybody who can give you a clear answer to that one. Only hopes and speculation and a lot of attempts, but no clear answer as to what was going to happen the next day.

Senator McINTYRE. One of the arguments on the floor of the Senate I'm sure will be that by doing this we are establishing a precedent and it is to this the discipline of the marketplace appeals to me as a very strong argument against taking this step, but I just want to end up by one comment.

Mr. Mulroy, you're certainly not going to suggest that the Government take the risk out of the bond market?

Mr. MULROY. No, sir.

Senator McINTYRE. Thank you, Mr. Chairman.

The CHAIRMAN. Before I call on Senator Javits, I'd suggest, if possible, that witnesses make their responses as brief and concise as they can because we do have so many witnesses ahead of us.

Senator JAVITS. Mr. Chairman, may I thank you and the committee for allowing me to sit in and question as if I were a member of the committee, which I'm not. I appreciate that you all appreciate my stake in this as a person.

I have lived in New York all my life and I dearly love the city, as do those who are concerned with its fate.

Mayor Landrieu, may I say to you that I hope you survive me by a great deal and I think the people of my city have deep debt of gratitude to you and to the U.S. Conference of Mayors. It would have been so easy to walk away, as even the White House has, but you're staying with us and I'm very grateful to you and I think you've got at least 8 million people who feel the same way.

Also, you slay a lot of dragons in this performance. The idea that New York was so different from every other place that it had to be punished uniquely or given punitive treatment, is an absolutely unheard of doctrine in this country since its founding. For a Cabinet official to say that 5 percent of the population has to have punitive treat-

ment is reminiscent of many other regimes, not an American regime. I'm grateful to you, too, for the passage in your written statement which points out that the criteria for anything this committee does—I hope this committee will act or the Congress as a whole does, or I'm now convinced there will be no initiative here except from the Congress—will be so tough that mayors and cities and municipal units of government and counties will not apply for it, and I find that passage at page 11 where you say :

I believe that I accurately reflect the thinking of mayors across the country when I say that none of them would opt for these kinds of severe criteria being imposed on them and their residents unless forced to do so as a last resort.

Is that a considered judgment by you?

MAYOR LANDRIEU. Yes.

SENATOR JAVITS. May I ask you, Mr. Mulroy, coming as you do from one of the finest cities in our State whether the precedent Senator McIntyre quite properly spoke about, the precedent of the Federal Government coming to the aid of the municipality—what about the precedent of the default of the greatest city in the world? That's going to be quite a precedent, isn't it?

MR. MULROY. I think it would be a disaster and, as I said, I think there should be constraints. I don't believe that the Federal Government should guarantee the municipal bond market because, if they did, that would automatically make every community in this country a AAA rated one and it would thereby penalize those communities that have worked for many years to keep and maintain a AAA rating.

I think this is an extraordinary circumstance and I'm sure that neither my country nor any other country that I know would like to go through what has been suggested here in my statement and the mayor of New Orleans' statement.

SENATOR JAVITS. Now, Mayor Beame, I'd like to address one question to you which properly comes from me to you. Those who don't love us speak of a bailout. It's constantly on the tip of the tongue of those who want to see New York go down the drain.

Now is it a bailout we're asking for?

MAYOR BEAME. Absolutely not.

SENATOR JAVITS. Or are the people of the city of New York and you, as their mayor and their government, ready to accept the most Draconian conditions in order to save the city's credit and the credit of municipalities and perhaps the business community throughout the United States?

MAYOR BEAME. Absolutely; it's not a bailout. It isn't a handout. We have in New York State, as was mentioned earlier an emergency control board with legislative powers which restrict the fiscal powers of the city of New York. No mayor wants to live with that. I could have stopped that legislation, but I felt that it as more important that the people of the city get the flow of cash so as to continue the services than my own personal pride. It's incredible to me to believe that any mayor in this country would just go along with any kind of spendthrift policies so as to get a Federal guarantee knowing full well that he will come in to a least be under restrictive requirements of any kind of Federal loan guarantee. I'm willing to continue that. I'm living under it, and to me it seems that the argument which has been made, if we open the doors they will all run in—now that's nonsense.

I do want to make one other observation as an aside, Senator, if I might, and that is that a question was raised about effect of default later on—that is, once we are faced with it, what would it mean afterward if we can temporarily solve that problem? I have here a partial list of people who are doing business with the city of New York who are going to be affected, not only New York businesses but people outside with whom we do business in the hundreds of millions of dollars; a contract with the Pullman Car in St. Louis for \$300 million—these people are going to be affected just as much as the people in our own city.

Senator JAVITS. Mr. Landrieu, I had a question to ask you. It might give you a footstool for what you wish to say on this question.

What will it avail the United States to make New York a “tincup” city, which is what the thrust of many of these arguments is about? The idea of go through the wringer, lose your credit for years, simply cut down and cut down and become a derelict. The 3 million that we have on the poverty margin or below are going to move to other cities. They’re going to move to Albuquerque, N. Mex., and others that don’t have them now. We’re paying now. They will pay tomorrow. The tax generation of New York which is about \$15 to \$20 billion a year, as against at the very most puffed up \$3.5 billion that Secretary Simon agrees we get back, that’s going to be heavily dented. New York is the center of commerce, communication, banking, stock and bond trading, and a thousand other things; all these things, that the country profits from and enjoys are going to be impaired or destroyed. That’s what we’re heading for with this parochial view which I believe is not characteristic of a Congress, though it may be of the White House.

MAYOR LANDRIEU. Senator, I find it difficult to understand the length or intensity of the debate. The solution to us is obvious and I’m really appalled at some of the answers that we have gotten, some of the reasons why action has not been taken and could not be taken up to this point in time; the suggestion that if you set this precedent every mayor of every city administration will continue its squandering practices. I can assure you that it is not the cities of this country or the mayors of this country that are expanding services. Those services are being expanded at the Federal and the State level.

We are in the guts of rendering civil service, police, fire, sanitation, and we lobby the halls of this Congress and every State legislature begging that no additional impositions be placed on us.

Second, the suggestion, Senator, is that other cities will emulate New York in its profligacy and as you pointed out by looking at the statement that we have submitted, New York is not paying salaries that are excessive in comparison to other large cities in this country. They do not have a percentage of employees to population base that is excessive.

Insofar as I’m concerned, although I think New York is the greatest city in the world and I always enjoy going there, I have also made it my business to see some of the unpleasant places in New York, some of the poverty and desperation, and it’s first in that, also. I can’t imagine why this country would want to force the greatest city in the world into bankruptcy when it’s totally unnecessary, and to create in the minds of nations in this world that we are so insensitive to our own people and to the prime financial city of this country.

I was told by some very high administration spokesmen that that's not a problem at all. They think the world will understand that situation. I'm not a financier. I'm only a politician. But I can assure you that you're not going to convince many people in this, No. 1, that the United States is not fiscally broke and, No. 2, that there is some kind of philosophical problem that prevents the U.S. Government from helping the 8 million people living in New York City. That's a difficult one to sell. So, Senator, I agree with your comment 100 percent.

Senator JAVITS. Mr. Chairman, may I offer for the record a staff study of the Congressional Budget Office which analyzes authoritatively all of these comparisons because I think it would be very, very useful.

The CHAIRMAN. That's the staff study that Mayor Landrieu referred to earlier?

Senator JAVITS. Yes.

The CHAIRMAN. Yes. That will be printed in full.

[The information follows:]

# **NEW YORK CITY'S FISCAL PROBLEM: Its Origins, Potential Repercussions, and Some Alternative Policy Responses**

**Background Paper No. 1  
October 10, 1975**



**CONGRESS OF THE UNITED STATES  
Congressional Budget Office  
Washington, D.C.**

PREFACE

New York City's Fiscal Problem is the first in a series of Background Papers issued by the Congressional Budget Office. It was prepared in response to a request from Congressman Thomas L. Ashley of the House Committee on the Budget for background information on the problems confronting New York City and their national ramifications. It is anticipated that Background Papers dealing with topics that are of considerable interest to the Congress and that potentially could affect the economy or the federal budget will be issued at irregular intervals by the Congressional Budget Office. In keeping with CBO's mandate to provide nonpartisan analysis of policy options, the report contains no recommendations. This paper was prepared by Robert D. Reischauer, Peter K. Clark, and Peggy L. Cuciti.

Alice M. Rivlin  
Director

October 10, 1975

SUMMARY

New York City's immediate crisis has been precipitated by its inability to borrow in the municipal bond market. Since April when this market closed for the city, a series of stopgap measures have provided the city with the funds it needed to avoid default. The aid provided by the latest of these measures -- the New York State Financial Emergency Act -- will run out in mid-December, if not before, and there are indications that the city and the state may be either unable or unwilling to take the drastic additional steps required to stave off default any longer.

New York must borrow now -- not because it requires funds to finance its long-term capital improvement program, but rather to refund its huge short-term debt. The bulk of this debt is attributable to deficits that the city has run in its expense budget over the past decade. It is estimated that the city's deficit for fiscal year 1976 alone will be over \$700 million.

With respect to the size of its short-term debt and its tendency to run current account deficits year in and year out, New York City is clearly unique. However, in other respects, New York resembles many of the other large cities of the northeast and northcentral regions. Like them, New York has been subject to pressures for increased spending while its tax base has eroded. However, unlike many of these jurisdictions, New York's revenues and expenditures are unusually sensitive to business cycles and the city has been required by New York State to shoulder an extremely high fraction of its welfare-related expenditures.

Discussion of the impacts of a default by the nation's largest city must be speculative both because there are no precedents for such a default and because much will depend upon the responses of public officials and investors. While severe national economic repercussions are possible if New York defaults, it is also possible that the effects outside of the New York area will be minor. The default procedures established by the New York State Financial Emergency Act call for the ultimate repayment of all principal and interest. In the period before a fiscal reorganization plan could be successfully implemented, some loss would be suffered by those who were forced to sell their New York City securities, but over the long-run the city's obligations are very likely to be met. The short-run impact of a default on banks would probably be moderated by the announced policies of the Federal Reserve System and the FDIC.

So far as other municipalities are concerned, the chief danger is that a default by New York could cause investors to desert the

municipal bond market. If this happened, other jurisdictions that rely on continued access to this market would have to pay higher interest rates and could be forced into temporary default as well. In addition, if New York State, by aiding the city, is forced into the city's predicament, the overall repercussions will be substantially greater.

There are a number of policies that could stave off a default by New York City, but these will require the participation of other levels of government. There is probably little New York City could do on its own that would restore investor confidence to the point that the city could soon reenter the municipal bond market. The state-dominated Emergency Financial Control Board has been given control over New York City's finances and is charged with presenting a three-year financial plan for the city which includes a balanced budget in fiscal 1978. This plan will undoubtedly call for sharp cuts in the city's budget -- cuts that themselves may cause substantial problems for the city and the long-run erosion of the tax base.

Since it seems unlikely that New York City or the Municipal Assistance Corporation will be able to reenter the bond market in December, only additional state or new federal actions will avoid a default. The state could provide the city with grants, borrow in the city's behalf or assume the responsibility for financing some programs such as welfare or higher education that are now borne by the city. The federal government could step in and provide immediate relief for the city through increased grants, direct loans to the city, bond guarantees, or bond reinsurance. Combinations of city, state, and federal policies are also possible.

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## I. THE BACKGROUND

New York City's current budget problems have been precipitated by its inability to borrow money in the municipal bond market. Since March, when New York was last able to sell notes on its own behalf, a series of stopgap measures have been used to keep the city solvent. First the city was advanced some \$800 million in state aid that it was scheduled to receive after the start of the fiscal year in July. Next, on June 10, the state established the Municipal Assistance Corporation (MAC) to serve as an interim borrowing agency for the city, in order to transform much of New York's short-term debt into long-term obligations. Originally, MAC was authorized to borrow \$3 billion, an amount sufficient to tide the city over until October. It was hoped that by this time the city would be in a position to reenter the bond market on its own.

While new city securities were unmarketable, it was anticipated that MAC bonds would be viewed differently by investors: first, because they were being issued by an agency of the state and carried with them the "moral obligation" of the state to meet any shortfall in debt services;<sup>1</sup> second, because the revenues from the city's sales and stock transfer taxes were to be diverted directly to the corporation to cover its debt service costs; and finally, because the city was directed to reform its financial practices and balance its budget under a new, state-approved accounting system.

In spite of these assurances, MAC immediately encountered difficulty borrowing for the city. Although MAC's first issue bore unprecedented tax-exempt interest rates of up to 9.5 percent, it could be marketed only with difficulty, even after a number of banks and insurance companies agreed to buy two-thirds of the total. When these bonds were freed from the sales price restrictions placed on them by the underwriting syndicate, they immediately plummeted in value, confirming a lack of investor interest in MAC bonds. In August MAC was able to borrow less than half of its planned offering, even though the

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1. A "moral obligation" requires the governor to include in his proposed state budget funds sufficient to cover any shortfall in debt service. This does not legally bind the legislature to appropriate these funds as would be the case of shortfalls associated with securities backed by the state's "full faith and credit."

new issue carried interest rates of up to 11 percent.

As August wore on, the New York clearing house banks that usually market New York City offerings became more reluctant to underwrite new MAC issues because these institutions were experiencing increasing difficulties reselling the bonds they already held to other investors. They found themselves holding more city obligations than they considered to be prudent banking practice. Thus in September MAC found itself in the situation that had faced the city in April -- unable to find a syndicate that would underwrite its borrowing.

The next stopgap measure was the Financial Emergency Act, which was approved by a special session of the state legislature and signed by the governor on September 9. This legislation was part of a plan to provide the city with roughly \$2.3 billion -- enough to meet its cash requirements through early December, by which time it is hoped the other elements of the plan will allow the city to reenter the bond market on its own. The key element in the plan is the Emergency Financial Control Board which is dominated by state appointees and charged with administering the city's finances. By late October this board must approve a three-year financial plan that includes transition to a truly balanced budget by fiscal year 1978, a reduction in short-term city borrowing, the removal of expense items from the capital budget, and a growth in controllable spending (all but welfare, pensions and debt service) of not more than 2 percent per year. The board is also given the responsibility for estimating the city's revenues and keeping spending within these revenue limits; reviewing and approving major contracts; approving all city borrowing; extending, if necessary, the pay freeze on city employees through fiscal year 1977; and dispersing city revenues, but only after it is satisfied that the expenditures are consistent with the three-year fiscal plan. The powers of the board extend to the city's semi-independent agencies which provide elementary and secondary education, higher education, hospital, and other services.

As with MAC, the emergency assistance plan ran into difficulties soon after it was put into effect, giving rise to concerns that this stopgap measure might not be sufficient to keep the city solvent even until December. Banks, insurance corporations, and private investors have not agreed to buy the full \$406 million in MAC bonds that the plan calls upon them to purchase. Some of the city and state pension funds, which are legislated to supply \$755 million of the \$2.3 billion total, have balked at investing in MAC bonds. The state pension funds have obtained a New York State Court of Appeals ruling, which states that, despite the provisions of the Financial Emergency Act, they cannot be required by legislation to purchase MAC bonds. Finally, the state, which has agreed to loan the city \$750 million, has encountered increasing difficulty in borrowing.

Although these notes were backed by the "full faith and credit" of the state, the state was forced to pay 8.7 percent on the first notes

issued to aid the city. Next, Standard and Poor's, which rates the risk associated with various municipal bonds, warned that, if the state extended more assistance to New York City than that called for in the emergency plan, it would be compromising its fiscal integrity and jeopardizing its high credit rating. Finally, Moody's Investors Service, another organization that rates bonds, withdrew its rating from the state's Housing Finance Agency, effectively squeezing this agency out of the municipal bond market and leaving it dependent upon the state for capital.

Moody's also lowered its rating of New York state and city securities. Thus it seems possible that, if it increases its support for the city, the state of New York may find itself in the same situation that faced the city in April and faced MAC in September. Yet, without further state involvement, it is unlikely that either MAC or the city will be able to market bonds after November. If this is the case, then for the third time this year New York City will be denied direct or indirect access to the municipal bond market. But why does the city need to borrow? And what would occur if continued access to the bond market were denied?

## II. THE CITY'S NEED TO BORROW

While most state and local governments borrow money, many can postpone issuing bonds or notes for a few months or even for an entire year if conditions in the municipal bond market appear to be adverse. However, New York City's situation makes such a delay impossible. In fiscal year 1976, the city's anticipated borrowing requirements are approximately \$8 billion. This borrowing has three different purposes.

Capital Projects. First, like almost all state and local governments, New York City borrows to finance capital projects. Generally long-term bonds are issued to pay for the construction of schools, public buildings, highways, sewers, and similar projects. The accepted rationale for financing such facilities with long-term debt is that all of the taxpayers who will benefit from such long-lived facilities should pay for them, and such payments should be made in instalments during the facility's usable life span. As of June 1, 1975, New York City had \$9.4 billion outstanding in long-term debt, the great bulk of which was backed by the city's "full faith and credit" through a first lien on tax revenues. A small portion of the debt was offset by money deposited in sinking funds. This debt represents roughly 6 percent of the nation's total long-term municipal debt.

Short-term bond anticipation notes are used by some states and local governments to support the construction phase of a project or to avoid borrowing in the long-term market when interest rates are abnormally high. New York has depended heavily upon issuing such notes, \$1.6 billion of which it had outstanding on June 30, 1975. Frequently the city has made little or no effort to substitute long-term borrowing for such bond anticipation notes, preferring instead to "roll over" or refund these obligations periodically. This has made New York particularly dependent upon continued access to short-term credit markets.

While long- and short-term borrowing for capital projects is accepted practice, there is evidence that in recent years New York has misused such borrowing authority by placing approximately \$700 million worth of items, which appropriately belonged in its operating budget, into the capital budget. This was one of the "gimmicks" the city used to present a "balanced" operating budget.

According to the city's budget, it planned to issue roughly \$2 billion in new obligations to support capital projects and to "roll over" between \$1.2 and \$1.8 billion in bond anticipation notes in

fiscal year 1976. If the city were unable to borrow for these purposes, its large capital improvement and construction program would eventually grind to a halt, causing a general deterioration of the city's stock of public buildings and facilities and exacerbating unemployment in the construction industry. Possibly of more immediate significance would be the necessary termination of the operating budget items that have been hidden in the capital budget.

Expenditure and Revenue Flows. The second purpose for which New York borrows is to match its income flow to its expenditure pattern. Spending occurs at a fairly regular pace throughout the year, driven by pay-rolls and welfare payments that must be met bimonthly or monthly and by the steady purchase of the goods and services required to keep city programs operating. Revenues, on the other hand, come in at more infrequent intervals. For example, property taxes are collected quarterly, state and federal aid may be paid quarterly or even annually. Lacking large unencumbered cash balances, New York, like some other states and municipalities, issues tax and revenue anticipation notes to tide itself over until the taxes or other revenues are obtained. If it operated in a prudent fashion, New York could be expected to require approximately \$1.5 billion in short-term debt in fiscal year 1976 for "legitimate" revenue anticipation purposes ("legitimate" in the sense that these notes could be repaid by revenues collected during the fiscal year). Without access to such borrowing, the city would have to reshape its expenditure pattern to that of its receipts or to build up cash balances sufficient to tide itself over periods of low revenue inflow.

Short-term Notes for Deficit Financing. The final purpose for which New York City needs to borrow in fiscal year 1976 is to "roll over" or refund \$2.6 billion in outstanding short-term notes and to finance this year's \$726 million projected current account deficit. The \$2.6 billion represents the accumulation of the past decade's operating deficits which have been financed each year primarily by issuing more revenue and tax anticipation notes than could be covered through actual revenue collections. The existence of this large short-term debt and the magnitude of the current deficit mean that New York must borrow every month or so regardless of how unattractive market conditions may be to "roll over" the part of its short-term debt coming due and to finance its monthly shortfall between current revenues and expenditures. The only alternative would be to repay the principal and interest due out of current revenues. The impracticality of this approach can readily be seen by the fact that it would absorb roughly half of the city's annual tax revenues, leaving little to support essential public services.

New York City had \$5.3 billion of short-term notes -- 29 percent of the national total -- outstanding on June 1, 1975. Had the market not closed for the city, New York could have been expected to issue between 27 and 33 percent of 1975's total short-term municipal notes.

To summarize, New York's borrowing needs in fiscal year 1976 total some \$8 billion. Had a crisis of confidence not emerged, the city would have issued \$2 billion long-term securities and sought an additional \$6 billion in the short-term market. Instead, the market effectively closed to New York City in April. MAC, first on its own and then with the assistance of the state, has stepped in to borrow for the city. The strategy behind this intervention is to substitute long-term securities for short-term notes, thus providing the city with an opportunity to reform its fiscal practices and accumulate surpluses sufficient to repay its past deficit-related debts.

## III. CAUSES OF THE PROBLEM

A variety of factors have contributed to New York's current fiscal problems. It is useful to distinguish the short-term factors that are responsible for precipitating the immediate crisis from those longer-term trends that have contributed to the city's deteriorating fiscal position.

Short-term Factors. The immediate crisis stems from a loss of investor confidence in the credit worthiness of the city. To some extent the sudden shift in the attitudes of investors towards the city's ability to meet its obligations must be attributed to psychological factors for surely the city's long-run economic outlook, which is what determines its ability to pay off its debts, cannot be much different today than it was one or two years ago.

Any discussion of the factors that affect the psychological attitudes of investors must be speculative. It is possible that investor confidence was eroded by the public debate and confrontation politics that took place between the mayor, the city controller, and the governor over the city's fiscal year 1976 budget. It is also probable that the temporary default of the New York State's Urban Development Corporation and the memories of the Penn Central, Lockheed, and Franklin National Bank collapses have made investors increasingly skittish. Any hint of financial instability may send them scampering away. Investor uncertainty becomes a self-feeding process, for the fewer the number of persons willing to lend the city money, the greater the probability of default and the greater therefore the uncertainty, and indeed, the risk.

However, it would be wrong to attribute all of the loss of investor confidence in New York to psychological factors. Objective market conditions should be considered as well. As Table 1 indicates, 1975 has proven to be an extremely heavy year for municipal borrowing. Therefore, New York has been forced to compete for funds with many other state and local governments with far sounder fiscal conditions as well as with the large borrowing requirements of the federal government. While the volume of issues has grown, the recession probably has diminished the desire and ability of banks, corporations, and individuals to buy tax-exempt bonds. This has clearly been the case with commercial banks; during the first quarter of 1975 they dropped out of the municipal bond market almost entirely (see Table 2).

With respect to individuals, it has been suggested that interest rates on municipal offerings have to be raised significantly to entice new buyers into the market. Such buyers must be drawn primarily from middle-income groups which benefit less from the tax-exempt status of municipal bond interest and are less capable of purchasing municipal bonds because these securities generally are available only in large denominations.

TABLE 1 -- Volume of Municipal Borrowing (1967-1975)  
(Amounts are par values in millions of dollars)

Year	Long-term	Short-term	Total
1967	14,300	8,000	22,300
1968	16,300	8,600	24,900
1969	11,700	11,700	23,400
1970	18,888	17,811	35,999
1971	25,006	26,259	51,265
1972	23,748	24,705	49,018
1973	23,957	24,705	48,662
1974	24,317	29,543	53,860
1975*	30,124	33,932	64,056

Source: Securities Industry Association, Municipal Market Developments.

\*Annual rate based on January - June volume.

TABLE 2 -- Annual Net Changes in Holdings of Municipal Securities  
by Major Holder Groups (1970-1975)

(Amounts are par values in billions of dollars)

Holder	1970	1971	1972	1973	1974	1975*	
						First quarter	Second quarter
Commercial banks	10.7	12.6	7.2	5.7	5.5	-2.7	6.9
Households	-.8	-.2	1.0	4.3	10.0	13.9	9.3
All other**	1.3	5.2	6.2	3.7	1.9	2.9	4.5
Total	11.2	17.6	14.4	13.7	17.4	14.0	20.7

Source: Unpublished flow of funds data from the Board of Governors of the Federal Reserve System (Processed: August 19, 1975)

\* Annual rate.

\*\* This includes corporate business, state and local general funds, mutual savings banks, insurance companies, state and local government retirement funds, and brokers and dealers.

Furthermore, the market for New York City securities is concentrated largely in New York State where the interest is exempt from not only federal but also state and local taxes. This market may be close to saturated by the large quantities of state and city securities outstanding. To broaden the market to nonstate residents would require interest rates sufficiently high to compensate for the fact that non-New York holders would have to pay state income taxes on the interest earned from their New York City securities.

The recession is a second short-term condition that has contributed to New York City's problems. Compared to other local governments, New York's revenue system is highly responsive to economic conditions because it relies heavily on cyclically sensitive sales and income taxes rather than on the more stable property tax. While property taxes accounted for 62 percent of the total revenues raised by the local governments serving metropolitan areas in fiscal year 1972-73, they accounted for only 43 percent of revenues raised by New York.

The recession's impact on New York's sales tax base is illustrated in Table 3. Despite a 9.3 percent increase in consumer prices in the year ending June 30, 1975, the volume of taxable sales in the city rose by only 1.7 percent. In New York even the property tax has proven to be unreliable. Delinquencies have risen rapidly from 4.2 percent of collections in fiscal year 1970 to 7.2 percent currently.

The recession has caused high unemployment and stationary incomes which have increased the city's expenditure requirements as well as undercut its expected revenue growth. Not only have the numbers of families eligible for welfare programs increased (see table 3), but it is also likely that the demand for other city services, such as hospitals, has been boosted by the recession because fewer city residents are able to afford the costs of the alternative private institutions.

The severe inflation of recent years has also had a negative effect on the fiscal position of New York. While in the long run, inflation may increase the value of the local tax base sufficiently to compensate for the decreased purchasing power of the tax dollar, in the short run, expenditure levels tend to be more responsive to inflationary pressures. This imbalance stems from the nature of property tax administration, for it is very difficult to reassess property rapidly enough to keep pace with the continually inflating market values of real estate.

Moreover, the situation is exacerbated by the long time period that transpires between the date at which the property tax levy is set and the dates on which the tax payments are due. In recent years a considerable amount of unanticipated inflation has occurred during these periods. It should be noted that New York's situation with respect to inflation may be better than that of other large cities, because of New York's heavy reliance on sales and income tax receipts which do respond quickly and automatically to price hikes and inflation-induced salary increases.

TABLE 3--- Measures of the Recession's Impact on New York City

Year	Unemployment Rate <sup>1</sup>	Welfare* Recipients <sup>2</sup>	Sales Tax* Base <sup>3</sup>
1970	4.8	101.5	78.1
1971	6.7	109.5	81.5
1972	7.0	112.9	NA
1973	6.0	106.4	91.9
1974	7.2	101.4	96.7
1974 June	6.9	100.0	100.0
July	7.3	100.2	100.4
Aug.	6.8	99.3	100.2
Sept.	7.3	100.5	99.1
Oct.	7.2	101.3	99.8
Nov.	7.4	101.3	99.6
Dec.	8.5	102.4	100.4
1975 Jan.	10.3	102.8	101.0
Feb.	10.2	102.5	101.0
Mar.	11.0	103.1	101.7
April	10.8	104.3	102.0
May	10.9	104.3	101.9
June	11.7	105.0	101.7
July	12.0		
Aug.	11.0		

Sources: 1. New York State, Department of Labor  
 2. New York State Department of Social Services  
 3. Annual figures from New York State Department of Taxation and Finance. Monthly figures from Municipal Assistance Corporation

\*Indexes use June 1974 as the base period (Sales Tax Base 100 = \$1.6 billion; Welfare Recipients 100 = 949,000). Sales Tax Base is equal to the total value of sales subject to taxation. Index is based on a twelve-month moving average to eliminate seasonal effects.

The Welfare index includes recipients under the AFDC and home relief programs.

Long-term Factors. The longer-term roots of New York's fiscal problem are both complex and difficult for the city to change. In part they represent the same forces that have buffeted the other large central cities of the northeast and north-central states. These cities have been called upon to assimilate a new wave of rural migrants into the industrial economy just when the industries offering employment opportunities are shifting their bases of operation out of the cities.

As a result of the immigration from the South, the out-migration to the suburbs, and the natural aging of the existing population, those more heavily dependent on city services -- the poor, the uneducated, the aged, the non-English speaking -- comprise an ever-increasing segment of the city's population. For example, between 1950 and 1970 the fraction of the city's population over 65 years of age has gone from 8.0 to 12.1 percent while the proportion of the city's families with incomes below the nation's median income level has risen from 36 to 49 percent.

The city's tax base has failed to grow as rapidly as its revenue requirements. This situation can be attributed to shifts in the location of economic activity as well as to the continued suburbanization of middle- and upper-income groups. Many industries are leaving the northeast altogether while others find it more profitable to operate in the suburbs or on the fringes of the metropolitan area. While its population has remained relatively constant, New York has lost jobs at a rapid rate over the last five years (see Table 4).

Year	Total Jobs <sup>1</sup>		Private Sector <sup>2</sup>		Population <sup>3</sup>	
	(in Thous.)	Index*	(in Thous.)	Index*	(in Thous.)	Index*
1960	3,538.4	94.5	3,130.2	98.4	7,782.0	98.6
1970	3,744.8	100.0	3,182.0	100.0	7,895.6	100.0
1971	3,609.4	96.4	3,040.2	95.5	7,886.6	99.9
1972	3,563.1	95.1	2,998.6	94.2	7,847.1	99.4
1973	3,538.4	94.5	2,964.0	93.1	7,664.4	97.1
1974	3,458.4	92.4	2,877.7	90.4	7,567.1	95.8
1975**	3,375.8	90.1	2,802.6	88.1	NA	NA

Sources: 1,2 -- Bureau of Labor Statistics

3 -- Bureau of the Census

\* Data Indexed using 1970 as base year.

\*\* January - June 1975

The city can exert little influence over either the population shifts or the tax base trends. Together they have produced a steady increase in city tax levels which has, in turn, probably affected the types of persons and businesses willing to remain in or move into the city (see Table 5).

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**TABLE 5--The New York City Tax Burden**

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Fiscal Year	Personal Income (\$ Billions)	Taxes* (\$ billions)	Taxes as Percent of Personal Income
1963-64	27	2.013	7.6
1964-65	28	2.193	7.9
1965-66	29	2.152	7.3
1966-67	31	2.410	7.7
1967-68	34	2.626	7.8
1968-69	37	2.802	7.6
1969-70	39	2.958	7.5
1970-71	41	3.178	7.7
1971-72	43	3.736	8.7
1972-73	45	4.017	8.9
1973-74	48	4.506	9.4
1974-75	50	5.111	10.2

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Source: New York City Finance Administration

\*Excludes fees and charges, stock transfer taxes and nonresident income taxes.

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An additional factor that has contributed materially to the city's fiscal problems is the manner in which the responsibility for providing welfare and health care services has been divided in New York state. New York is one of only twenty-one states that requires its local governments (e.g. counties) to contribute to the support of cash assistance for the aid to families with dependent children program (AFDC) or to Medicaid payments. Of these twenty-one states, the local share is the highest in New York, where it amounts to almost one quarter of the total or half of the nonfederal share (see Table 6).

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TABLE 6 -- Fraction of AFDC Cash Assistance and Medicaid Payments Borne by Local Governments (Fiscal Year 1974)

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State*	Percent
New York	23.0
Minnesota	21.8
Wyoming	18.5
California	14.5
Kansas	11.3
Colorado	9.4
Nebraska	8.8
Nevada	8.3
No. Carolina	8.3
Indiana	6.9
New Jersey	6.5
Iowa	4.8
No. Dakota	4.6
Maryland	4.2
Montana	2.8
Virginia	0.6
Utah	0.6
Louisiana	0.2
Oregon	0.1
New Hampshire	**
Mississippi	**

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Source: Department of Health, Education, and Welfare, "State Expenditures for Public Assistance Programs."

\* States not listed do not require any local contribution.

\*\* Less than 0.1 percent.

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While county governments in New York also must bear half of the cost of the Home Relief Program, New York State's relatively generous general assistance program, this division of responsibility does not differ from the pattern that prevails in the rest of the nation. All told, New York City's welfare-related expenditures amount to some \$3.5 billion, or approximately one third of its current spending. One billion dollars of this must be raised by the city. If the city constituted just part of a large county -- as is true of Los Angeles, Newark and all but a handful of the large cities located in the twenty-one states requiring local welfare contributions -- the costs of supporting the city's income security programs would be shared by some suburban jurisdictions. However, being a city-county, New York must bear the cost alone.

New York's long tradition of providing enriched levels of public services also has contributed to its current fiscal difficulties. The more obvious services in which New York far outdistances most other local

governments include the city university system, the municipal hospital system, the low- and middle-income housing programs, and the extensive public transportation network. For many years there seemed little doubt that the city's wealth was sufficient to support its chosen level of services. However, in recent years it has proved difficult politically to reduce services in line with the city's declining relative fiscal ability to afford them or to raise taxes and fees.

Finally, one cannot ignore the city's questionable accounting procedures and loose fiscal management in relation to the current crisis. These procedures masked the fact the New York officials were failing to make the difficult choices that were required if the city's expense budget was to be truly balanced as required by law.<sup>1</sup> The fault does not rest with the city alone. Many of the "gimmicks" which allowed the budget to appear balanced were tolerated or even suggested by state officials and were certainly not secrets to the banking community. These "gimmicks" produced small deficits which were allowed to accumulate and grow, producing a problem of large and unmanageable proportions.

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<sup>1</sup>"Annual budget and financial reports are filed with the Division of Municipal Affairs in the office of the State Comptroller. Budgets are reviewed in substance and legality.... Deficit financing is not recognized in the operation of units of Local Government in New York State and can only be legally validated by legislative enactment." Advisory Commission on Intergovernmental Relations, City Financial Emergency, Washington, D. C. 1973, p. 168.

## IV. IS NEW YORK UNIQUE?

Are New York's problems simply of a larger magnitude or are they qualitatively different from those of other major cities? Much of the public discussion suggests that New York is very different from other cities, that it has an abnormally large welfare population, an unusually large and well-paid public labor force and has expenditure patterns that are significantly higher than other cities. At the same time, there is the belief that the fiscal crisis being visited upon New York soon will afflict other cities. Generally neither of those contradictory sets of impressions is valid.

In recent decades New York has been buffeted by the same socio-economic forces that have affected other large, older urban centers and has responded to these pressures in a fashion similar to that of other cities. According to most measures, New York's situation is far from the worst in the nation. One composite index of central city disadvantage shows New York in better shape than Newark, Baltimore, and Chicago as well as eight other large urban centers not included in Table 7 (see column 1). A smaller fraction of New York's population receives welfare than is the case in Philadelphia, Baltimore, Newark, or Boston (see Table 7, column 2).

Comparisons of the expenditure and employment patterns of New York City with those of other large municipal governments indicate that New York is far out of line with other jurisdictions (see Table 7, columns 3a and 4a). Yet this is a misleading conclusion which stems from the fact that New York City provides services that in other areas may be supplied by a county government, a school district, or another specialized government. If one compares the New York employment and spending patterns with those of all of the local governments providing services to the residents of other large cities, New York appears to be less extraordinary (see Table 7, columns 3b and 4b). While its per capita expenditure and public employment levels are above those of any other major city area, some of the differences with respect to such cities as Boston and Philadelphia can be explained by the fact that welfare is a state function in Massachusetts and Pennsylvania. While New York also spends a great deal more than other cities on higher education, hospitals, and mass transportation, its expenditure on the services commonly provided by municipalities is not out of line with those of other large cities (see Table 7, columns 3c and 4c). With respect to the salaries paid public employees, New York is generous but not the most generous of large cities (see Table 7, column 5). Considering that New York's cost of living -- as measured by the Bureau of Labor Statistics (BLS) intermediate family budget -- is

TABLE 7--New York City Compared  
To Other Large Central Cities

City	(1) Index of Central City Dis- advantage	(2) Fraction of Popu- lation Receiving Welfare Payments*	(3) Per Capita Expenditures 1972-1973			(4) Local Government Employment Per 10,000 Population 1974		
			(a) City Govern- ment	(b) All Local Governments Serving Central County	(c) All Local Governments * Serving Central County	(a) City Govern- ment	(b) All Local Governments * Serving Central County	(c) All Local Governments * Serving Central County
New York City**	211	12.4	\$1,224	\$1,286	\$435	517.1	528.2	242.9
Boston	198	16.9	858	756	441	378.0	465.0	219.2
Chicago	245	11.1	267	600	383	140.0	352.5	208.4
Newark	422	14.4	692	827	449	391.1	421.5	258.2
Los Angeles	105	8.0	242	759	408	162.2	401.1	206.2
Philadelphia**	205	16.2	415	653	395	163.8	414.5	255.2
San Francisco**	105	9.1	751	1,073	488	312.5	488.3	224.6
New Orleans**	168	11.4	241	431	260	177.3	357.7	217.5
St. Louis**	231	15.8	310	610	360	241.9	424.6	214.2
Denver **	143	7.2	473	721	375	237.0	410.5	219.3
Baltimore**	256	16.3	806	814	470	434.1	434.1	260.1
Detroit	210	11.1	357	650	396	194.8	354.3	202.4

\* Central County.

\*\* Boundaries of the city are coterminous with those of the central county.

\*\*\* Common Municipal Functions include elementary and secondary education, highways, police, fire, sanitation, parks, general control and financial administration.

continued

TABLE 7 -- (Continued) New York City Compared  
To Other Large Central Cities

City	(5) Public Employee Average Salaries 1974				(6) Cost of BLS's In- termedi- ate Family Budget (Index 1974)	(7) Debt Outstanding per capita 1972- 73*	
	(a)	(b)	(c)	(d)		(a)	(b)
	Teacher	Police	Fire	Sanita- tion		Total	Short- term
New York City	\$17,440	\$14,666	\$16,964	\$15,924	116	\$1,676	\$352
Boston	16,726	14,352	13,844	10,666	117	1,385	334
Chicago	20,891	14,146	15,525	11,956	103	733	169
Newark	16,464	13,282	13,282	8,473	116	616	112
Los Angeles	15,670	15,833	21,180	13,168	98	650	14
Philadelphia	15,354	14,354	13,869	13,337	103	1,015	101
San Francisco	15,743	15,529	17,765	13,023	106	1,225	151
New Orleans	10,458	10,746	10,645	4,170	NA	770	39
St. Louis	17,545	11,748	13,185	9,593	97	731	49
Denver	13,505	12,907	14,198	10,258	95	786	52
Baltimore	12,727	10,098	10,980	8,126	100	609	45
Detroit	22,603	15,636	16,107	13,814	100	658	63

Sources:

1. Richard Nathan "The Record of the New Federalism: What It Means for the Nation's Cities," Brookings Institution, 1974.
  2. Department of Health, Education and Welfare, Recipients of Public Assistance Money Payments and Amounts of Such Payments by Program, State, and County. February 1975 DHEW Pub. No. (SRS) 76-03105 NCS Report A-8 (2/75). Includes AFDC and general assistance recipients.
  - 3a. U.S. Bureau of the Census, "City Government Finances in 1972-73," GF73, No. 4.
  - 3b,c,7 U.S. Bureau of the Census, "Local Government Finances in selected Metropolitan Areas and Large Counties 1972-73," GF 73, No. 6.
  4. & 5. U.S. Bureau of the Census, "Local Government Employment in Selected Metropolitan Areas and Large Counties 1974," GE74, No. 3.
  6. Bureau of Labor Statistics, "Autumn 1974 Urban Family Budgets and Comparative Indexes for Selected Urban Areas." (4-9-75).
- \* Central County

higher than all but that of Boston, its wages are not particularly out of line (see Table 7, column 6).

However, it should be noted that what little reliable evidence there is seems to indicate that New York City provides its employees with considerably more in the way of fringe benefits--pensions, health insurance, etc.--than is offered the employees of other large cities.

While New York's situation in many ways does not differ markedly from that of other large central cities, some of its problems are clearly not shared with other cities. First there is New York's debt situation. On a per capita basis the city has far more debt outstanding than do the local governments providing services in the other central city areas (see Table 7, column 7). This is particularly true of short-term debt in which New York stands alone in its needs continually to enter the market to "roll over" large quantities of notes. Second, New York, as far as can be told, has been the only major city that has chronically run a large current operating deficit in both good and bad economic years. Finally, as was mentioned previously, New York revenues and expenditures are much more sensitive to the ups and downs of the business cycle. All of these peculiar aspects of New York's situation should make one pause before concluding that the city's crisis is but the forerunner of those that will occur widely elsewhere.

## V. THE EFFECTS OF DEFAULT

New York City is likely to default on its obligations if, as now seems probable, the city and the state or MAC acting in the city's behalf are unable to borrow large amounts of funds after the transfusion provided by the emergency assistance plan is used up. Just what form a default would take and what the repercussions of such an event would be cannot be predicted with any degree of certainty. While it is possible that the collapse of New York would precipitate a storm of bankruptcies in the private sector and a wave of municipal defaults, it is also possible that a default by the city would generate but a ripple on the nation's financial waters. Much would depend upon how public officials and policy makers chose to deal with the situation and how default would affect the psychological attitudes of investors.

The New York State Financial Emergency Act authorizes a procedure that would probably be followed in the event that the city were forced to default on its obligations. Under this procedure, no creditor would be permitted to seek ameliorative action in the courts for thirty days. During that time, the municipality or the Emergency Financial Control Board could file a voluntary petition to the state supreme court indicating its inability to pay its debts and stating its intention to file a repayment plan. On receipt of the petition, the court would stay individual court proceedings for an additional ninety days. The repayment plan would have to provide for the eventual payment of both principal and interest. This payment would have to be made as soon as possible, although consideration would be provided for the maintenance of essential public services. Any creditor who agreed to receive payments under the plan would be enjoined from further court actions.

It is important to recognize that the procedure outlined in the Financial Emergency Act is for default rather than bankruptcy; under the default procedure all debts must be paid eventually. The state law also permits the city, if it prefers, to file for bankruptcy under the Federal Bankruptcy Act. Under that law, 51 percent of all creditors must petition the court to initiate proceedings; creditors holding two-thirds of all outstanding debt must agree to a financial adjustment plan which spells out the timetable and extent to which creditors would be repaid. Since New York City issues "bearer" rather than "registered" obligations, no one has an exact fix on who the city's creditors are. Lacking this information, it may be impossibly complex for the city to use the procedures of the Federal Bankruptcy Act.<sup>1</sup>

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<sup>1</sup> Treasury Secretary William Simon, testifying before the Joint Economic Committee of Congress on September 24, 1975, indicated that the Administration soon would propose amendments to the Federal Bankruptcy Act that would make this Act more useful to local governments. A number of bills having this objective have been introduced by members of the Congress and hearings are scheduled or have taken place in both houses.

- Even a default under the Financial Emergency Act would, no doubt, involve some losses to holders of New York City debt. The bonds and notes would be relatively illiquid until the reorganization plan was approved and the city showed that it could meet the repayment schedule. Debtholders forced to sell their bonds or notes during this period of illiquidity could suffer substantial losses. Debtholders who were able to maintain their position until the repayment plan proved workable might not sustain any loss if market rates of interest were paid for the extended payment period. In fact, holders of city securities that were purchased during the period of uncertainty when yields were high might reap large capital gains, if the city showed an ability to meet the repayment schedule and if this pushed the interest rates the city had to pay for new borrowing below the levels of the past six months.

The extent to which the value of bonds in default would be depressed would be related to the market's assessment of the repayment plan and New York's ability to meet it. Certainly the bonds would not become worthless, but the losses could significantly affect the behavior of their holders. While no one can provide a precise figure, banks hold a substantial amount of New York's securities. It has been estimated that the large New York City banks hold roughly \$2 billion of the \$14.6 billion in outstanding debt. Two billion dollars represents less than 25 percent of the equity capital of these banks and something under 5 percent of their total assets. Other banks throughout the nation also hold New York securities. A recent survey by the Federal Deposit Insurance Corporation (FDIC) of the roughly 9,000 banks that are not members of the Federal Reserve System indicated that approximately sixty had more than half of their capital in New York City securities; another 200 had between 20 and 50 percent of their capital invested in such bonds and notes. Probably a similar proportion of the approximately 5,000 banks that are members of the Federal Reserve System have large holdings of New York City securities.

Banks holding large amounts of city securities would not be unscathed if New York's bonds and notes plummeted in value because of a default. However, the impact would be lessened by the Federal Reserve's stated willingness to both lend funds to member and nonmember banks whose solvency would be jeopardized by a city default and to permit banks to value city securities at their predefault levels. The FDIC's contingency plan to lend funds to banks caught by a municipal default rather than forcing these institutions into receivership would have a similar effect. Under such conditions it is doubtful that any banks would be forced into bankruptcy if the restructuring of the city's fiscal situation is accomplished in a reasonable period of time. In any case it should be noted that the FDIC would protect all but the largest depositors from suffering any loss should there be any bank failures.

Insurance companies and individuals also hold a large portion of New York City's debt. It is unlikely that the former would be seriously affected because their payout streams are generally very uniform and they usually have highly diversified sources of income. Individuals would be hurt to the extent that the market value of the defaulted bonds fell, but the vast majority of such holders are high-income persons who have been attracted to municipal bonds by the tax-exempt status of the interest. Most such persons presumably have other resources to fall back on if their interest earnings and assets from New York City shrink.

The impact of a New York City default on the municipal bond market is much more hazardous to predict. To date, the evidence indicates that New York's problems have had little, if any, impact on the situation facing most municipal borrowers. Yields on municipal issues have maintained their historic relationships to those on corporate issues of comparable maturity and quality (see Table 8). While municipal rates have edged up recently, so too have the rates for corporate and federal securities. Of course, it is possible that when more recent data are processed, they will show that a dramatic shift has taken place.

There are some significant exceptions to these generalizations. Investors have clearly started to shy away from low quality municipal offerings. However, the extent to which this is the by-product of New York's difficulties rather than the competition from an unusually large quantity of high quality municipal and treasury offerings cannot be determined with precision. Some large, older cities, especially those in the eastern and northcentral areas, have been forced to pay unusually high rates of interest, probably because of their superficial fiscal resemblance to New York. For example, the rate paid by Philadelphia rose from 6.5 percent in February to 8.5 percent in July. Detroit, partly because of its extremely high unemployment rate and its budgetary problems, has been forced to pay roughly 9 percent throughout 1975. The specter of a city default dragging down the state has forced New York State's rate up to 8.7 percent. It also should be noted that certain borrowing agencies such as the Housing Financing Agency in New York and its sister organization in Massachusetts, both of which relied on rolling over short-term notes to avoid the high rates associated with long-term borrowing, have been forced out of the market completely because no syndicate will underwrite their bonds.

A default by New York City could cause this situation to become more widespread. Banks, individuals, and insurance companies may be unwilling to risk new capital in the municipal market until the dust from the city's default settles. Fiduciaries may shy away from this market out of a fear that they would be liable for investing in risky securities. If such a reaction occurs, it would cause a widespread crisis among the states and localities that depend upon access to credit.

TABLE 8 -- Ratio of Yield on Long-Term, Tax-exempt Municipal Securities to Yield on Long-term, Taxable Corporate Securities (1960-1975)  
(Tax-exempt as a Percent of Taxable Yield)\*

Year	High Quality (Aaa) (Monthly Range)	Lower Quality (Baa) (Monthly Range)
1960	.717 - .757	.790 - .830
1961	.729 - .774	.774 - .819
1962	.680 - .726	.707 - .789
1963	.701 - .732	.725 - .748
1964	.678 - .717	.729 - .744
1965	.670 - .726	.715 - .753
1966	.698 - .736	.694 - .773
1967	.657 - .708	.658 - .712
1968	.664 - .709	.681 - .716
1969	.695 - .842	.730 - .817
1970	.682 - .826	.636 - .816
1971	.642 - .758	.634 - .737
1972	.673 - .725	.667 - .703
1973	.638 - .699	.631 - .694
1974	.642 - .748	.639 - .743
1975 Jan.	.724	.702
Feb.	.691	.674
Mar.	.724	.705
Apr.	.722	.719
May	.721	.715
June	.716	.720
July	.723	.736
Aug.	.715	.745

Source: Federal Reserve Bulletin, monthly indexes of daily data compiled by Moody's Investors Service.

\*Ratios were calculated for each month. The highest and lowest (monthly) ratios are reported for years 1960-1974.

No one knows how many jurisdictions can avoid borrowing for a period of months, but undoubtedly a number of large cities and states would be forced into default, at least temporarily, if they were denied access to the bond market. For the most part these jurisdictions would be those that had counted on rolling over or refinancing their bond anticipation notes. Those governments that depend upon revenue or tax anticipation borrowing need not default; rather they would have to restructure suddenly their expenditure pattern to conform to their inflow of revenues. In some cases this would entail severe temporary service cutbacks. For the governments that borrow for long-term capital construction, a temporary closing of the credit market would mean a postponement of building schedules which would affect the level of activity in the construction industry.

It is also possible that the municipal bond market is fairly sophisticated and that it has differentiated on objective grounds the situation facing New York and a few other jurisdictions from that facing the vast majority of other municipal borrowers. In fact it has been suggested that the possibility of a default by the city may be largely or even fully discounted by the market already. If this is true, the major repercussion may well be a general feeling of relief that default, like impeachment, is a storm that can be weathered. A new sense of stability could return to the municipal market, especially if the city were able to reorganize its debt quickly and prove that it could meet the payment schedule on its restructured obligations.

Default would have a profound effect on New York City. Some city services could be temporarily disrupted if city employees, fearing that they will not be compensated, refused to work or if vendors and contractors refused to provide the city with goods and services except on a cash basis. The reorganization plan that would result from a default would probably call for an approximate balance between receipts and expenditures, a goal that according to current plans won't be attained until fiscal year 1978. This would be a difficult undertaking. The city's budget for fiscal year 1976 is \$12.3 billion, with the deficit estimated at \$726 million. Almost one-half of this budget is comprised of items such as welfare, pensions, and debt service that are relatively uncontrollable. Balancing the city's budget would involve either massive cuts in employment and services in other areas or sizable increases in taxes. The city's dilemma is obvious. Cuts in employment and wage rates are likely to be unacceptable to the city's employees, while tax increases are likely to further erode the tax base. New York has managed to maintain a high level of public services only by running large deficits each year. It may be impossible to maintain these services on a pay-as-you-go basis when corporations and middle class taxpayers have the option of relocating to avoid higher taxation. On the other hand, from a political standpoint it may be impossible to cut these service levels.

A large expenditure cutback by New York City would have a noticeable impact on the federal budget. Crude estimates suggest that were the city to balance its budget by cutting its spending by \$726 million, the federal government's deficit could rise by somewhere between \$300 million and \$400 million. This would occur partially because federal tax receipts would fall when city and private sector workers lost their jobs because of the cutback and partially because these individuals and their families, to some extent, would rely on unemployment, welfare, food stamps, medicaid, and other benefits that are totally or partially supported by federal expenditures. Yet, it should be noted that such a cutback would represent a net reduction of \$200 million to \$300 million in the total deficit of the public sector -- while New York's deficit would be reduced by \$726 million, the federal deficit would rise by roughly half that amount. It should also be noted that both the city and state budgets would be impacted in a similar way -- tax revenues would fall while expenditures would be forced up. This suggests that a slightly larger cutback than \$726 million would be needed to truly balance the city's budget.

## VI. POLICY ALTERNATIVES

Four questions must be addressed in any discussion of the policy options for dealing with New York's financial crisis: First, what level of government should act? Second, what action should be taken? Third, who should bear the costs, if any, of the policy? Fourth, should the policy be tailored exclusively for New York or should it apply to a broader group of jurisdictions? The policy options open to each level of government -- New York City, New York State, and the federal government -- are discussed in turn.

New York City. At this advanced state of the financial crisis, few, if any, options remain open to the city acting alone. The only obvious course of action would be the immediate institution of draconian budget cuts and sharply higher taxes, so that the city would operate with a sizable budget surplus that could be earmarked for the rapid liquidation of the city's deficit related short-term debt. The three-year fiscal plan required by the Financial Emergency Act should encompass some actions along these lines. The difficulties and possible repercussions of this approach were discussed in the previous section.

The basic case for requiring the city to "save" itself rests on the widespread feeling that most of the "blame" for the city's current situation must rest with the past "irresponsible" behavior of city officials. Moreover, there is an understandable reluctance of persons from outside of the New York area to assist the city when their localities provide neither the range nor levels of services offered New York's citizens.

The basic reason for not requiring the city to attempt to "save" itself is that it is probable that nothing the city can do quickly and on its own would be sufficient to restore investor confidence. Balancing the budget by means of large service cuts and tax increases may be impossible from a political perspective. To a majority of New Yorkers, default may be a preferable alternative, one that may involve less drastic reductions in services and a more gradual increase in taxes. From the perspective of the investor who is being asked to loan the city capital over a long period of time, drastic fiscal reforms instituted by the city may not be credible. There may remain a fear that as soon as the spotlight of public attention had been turned off, the city would return to its old ways.

From a technical standpoint, it is unlikely that the city could make the sudden and drastic reductions in expenditures that would be required. Like the federal budget, much of the city's expenditures fall into the category of "relatively uncontrollable" (welfare, debt service, pensions, etc.). Significant reductions in overall spending would, therefore, require the gutting of many of the remaining "controllable," basic services

and deep cuts in personnel. MAC has estimated that roughly 46,000 employees or 15 percent of the work force of the city and its semi-independent agencies -- would have to be laid off just to balance the budget. To accumulate a sizable budget surplus would require deeper cuts. Finally, a drastic reduction in services could undercut the local economy to such a degree that the welfare-related service demands placed on the city would be increased significantly and tax revenues decreased, thus counteracting some of the anticipated savings.

New York State. The state represents the second possible source of policies that could alleviate the city's fiscal crisis. The basic reason for advocating state action is that, traditionally and legally, the responsibility for dealing with the problems of cities, and local governments in general, has been a state one. Furthermore, several of the city's current problems can be traced to state policies. First, the state acquiesced to the budget "gimickry" that permitted the city to build up its huge short-term debt.

Second, and more fundamentally, the division of service responsibility between the city and the state has contributed to the long-run causes of the city's dilemma. Since some other states keep a closer reign on the fiscal behavior of their cities and most do not place such heavy welfare burdens on their cities, political leaders elsewhere are likely to view New York City's problems as primarily a state responsibility. To this case for state action can be added the probability that the state could initiate new policies sooner than could the federal government and that state policies would be better tailored to fit the special needs of the city than would be programs developed from a federal perspective. Already the state, through the Financial Emergency Act, has put in motion a strict program of fiscal reforms for the city, one that for all practical purposes shifts the locus of fiscal decision making from the city to the Emergency Financial Control Board.

The case against relying on the state to act is that it may be beyond the state's fiscal capacity or current ability. In fact, it has been argued that the city may well prove to be an albatross that brings down the state, forcing it to default as well. Already without assisting the city, New York State is expected to incur an operating budget deficit of over \$600 million in fiscal year 1976. Furthermore, despite the Financial Emergency Act, implementation of strict or costly state measures to control the city's finances may be as politically infeasible as local reforms. The significant fraction of the state's voters who live in New York City may oppose harsh measures, while many of those living in the remainder of the state may be unwilling to support costly state assistance.

There are several conceivable types of action that the state might take to aid the city. First, should investors still be unwilling to purchase city or MAC securities in December, the state could extend additional amounts of aid to the city by borrowing in its behalf. As has already been mentioned, it is possible that this avenue may be closed if

investors begin to react to state securities as they have to city and MAC issues. The high rates of interest charged the state in September suggest that this process may be beginning. Of course the state need not borrow; it could raise its taxes sharply to generate the necessary revenue. However, to raise the \$3.5 billion needed by New York City between mid-December and the end of the city's fiscal year would require roughly a one-third surcharge on all state taxes and fees.

The second approach that the state might take would be to assume the responsibility for one or more of the services currently being provided by the city. Welfare services are the most obvious candidate for such a shift in responsibility. Under federal law the state determines eligibility requirements and benefit levels; therefore, the city already has virtually no control over its welfare budget although it must pay one-fourth of the cost. State assumption of welfare-related services would provide the city with a net saving of some \$900 million per year, more than enough to balance its budget. Furthermore, it would reduce the total spending of the city by roughly one-third. Of course, from the state's standpoint, the takeover of welfare would be more costly because Albany would have to assume the local welfare burden in the remainder of the state as well. All told this would add about \$1.2 billion to the state budget.

The City University system is another candidate for a state takeover. Currently the city spends approximately \$500 million for its four year colleges and graduate programs, 40 percent of which is contributed by state or federal aid. Therefore, a state takeover of the University would save the city roughly \$300 million. The cost to the state of such an action need not be as great as the savings to the city if the state integrates the City University into the state education system and institutes its tuition and fee schedules. Moreover, in contrast to the situation with respect to welfare, the state would not have to assume a similar burden from other local governments because no other localities in the state support extensive systems of higher education. Mass transit, courts, pensions, and elementary and secondary education represent other service areas for which the state could either assume direct fiscal responsibility or contribute an increased amount of state aid.

It is important to realize that any of these alternatives would necessitate sharply higher state taxes. The net benefit to New York City's taxpayers would depend upon which service was assumed by the state and what mechanism was used by the state to raise the necessary revenues. It is possible to make city taxpayers worse off in an absolute sense with the state assumption of certain services. This possibility was demonstrated by the Fleischmann Commission's plan which called for state assumption of the fiscal burden of elementary and secondary education and imposition of a uniform state level property tax.<sup>1</sup>

<sup>1</sup> Report of the New York State Commission on the Quality, Cost and Financing of Elementary and Secondary Education. (The Commission, 1972, Vol. I.)

The Federal Government. The federal government clearly has the resources to stave off a city default. It also has the clout to ensure that there is a real restructuring of New York's fiscal practices. As has been mentioned, any plan put forward by either city or state officials may be crippled by political considerations. Some fear that, despite the Financial Emergency Act, the environment that allowed the accumulation of \$3.3 billion in deficits still exists; city and state officials will still be sensitive to these pressures and may be unable to devise and implement a plan that can balance the city's budget and reduce its debt.

The rationale for federal intervention rests on the belief that New York plays a vital role in the national and world economies and, therefore, its fiscal health is an issue that transcends the responsibility of any one state. Moreover, the possibility that the city's default would adversely affect national money markets and the economic recovery would seem to argue for federal policy initiatives. The arguments against federal action are three-fold: first, that it is not the place of the federal government to intervene in the detailed operation of a local government's finances; second, that on distributional grounds the federal government should not be helping an area with above average public services support those services when it does nothing for jurisdictions with less adequate services; and finally, that any federal policy would have to include many other units of local government and thus would result in too large an increase in federal government activity.

To date, the federal government has refrained from active participation in New York City's financial problems. Since the current stopgap solution provides relief only through mid-December, the federal government will have to decide soon whether to intervene actively in the next crisis, or remain in its present passive posture.

The present federal policy is one that could be continued. Chairman Burns has stated that the Federal Reserve System stands ready to lend money to banks which encounter cash-flow problems due to default on city or state bonds. This reduces, if not eliminates, the possibility that banks will fail in domino fashion as they try to meet their temporary cash demands. This policy and the existence of the Federal Deposit Insurance Corporation makes a "run" on banks holding defaulted bonds and notes extremely unlikely. As has been mentioned previously, default is likely to involve delayed payments rather than a total write-off of principal and interest. Banks which are large holders of New York City securities can, in the worst of circumstances, envisage a short-term cash flow problem.

Direct Assistance. Direct assistance in the form of a new grant or advance payment of existing grants, at most, would postpone the city's financial problems for a short period unless a massive grant designed exclusively for New York City could be legislated. Presently, the only new grant program which both would provide a significant amount of aid to New York and which has even the remotest chance of quick legislative approval is the Intergovernmental Anti-Recession Assistance Act of 1975 (S. 1359) which was passed by the Senate in July. This program would partially protect

New York City as well as other local governments and states from recession induced revenue shortfalls and expenditure increases. However, under current economic conditions this program, if fully funded, would provide New York with only \$138 million, enough to cover one-fifth of its current deficit or its average short-term borrowing needs for two weeks.

Advanced payment of existing grant-in-aid monies (revenue sharing, Medicaid, state school aid, etc.) is also not likely to help out much. Secretary Simon estimated that at most, approximately \$200 million could be advanced to New York City from federal programs.<sup>1</sup> Considering that the state has already advanced New York much of its state aid, this route to temporary fiscal salvation does not look promising at the state level either. In any case if New York City were advanced its federal grant monies, it is likely that other cities and states would demand equal treatment. If this were granted, the Treasury would be forced to increase its short-term borrowing and the interest associated with this action would add marginally to the federal deficit.

Purchase of New York City Debt. At present, the Federal Reserve System (Fed) is the only federal entity that could buy municipal debt without new enabling legislation. However, the Fed interprets its power to do so to be valid only in cases in which the problem is a temporary one and only when the Fed is certain of prompt repayment.<sup>2</sup> Since it is the Fed's opinion that neither of these two criteria is met by the New York City situation, it has not shown a willingness to provide assistance.

There are other federal or quasi-federal agencies that buy obligations and issue their own debt. FNMA and GNMA provide a secondary market for mortgages and mortgage commitments. The Federal Financing Bank (FFB) purchases the debt of some federal agencies as well as some nonfederal debt that has been federally-guaranteed. The FFB currently pays for these with money that it borrows from the Treasury at slightly over the market rate for Treasury bonds. None of these agencies can buy New York City obligations under current law.

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1. Statement of Treasury Secretary William E. Simon, before the Subcommittee on Commerce, Consumer and Monetary Affairs, House Committee on Governmental Operations, June 26, 1975.
  2. See the statement by George W. Mitchell before the Subcommittee on Commerce, Consumer and Monetary Affairs of the House Committee on Governmental Operations, June 25, 1975, for an explicit treatment of the Federal Reserve System's authority.

Federal purchases of New York City debt, whether by the Fed, some existing federal agency acting under new legislation, or a new federal agency, amounts to refunding the city debt by increasing the obligations of the U. S. Government.<sup>1</sup> Such a scheme has the attractive feature that the interest income from the bonds or notes issued would be taxable, thereby reducing the loss of federal income tax revenue associated with tax-exempt municipal bonds. The net cost to the federal government of a refunding operation that transforms New York city debt into federal debt would have three components: first, a gain due to the increase in tax receipts stemming from the taxable nature of the interest income on federal bonds; second, an "expected" loss due to the possibility that New York City may not repay the federal government; and finally, a gain amounting to any premium that the federal government decided to charge the city over the prevailing Treasury bond rates.

The cost to New York city would obviously be the Treasury bond rate plus any premium charged by the Fed or other agency. If the probability that New York City will have to delay or skip payments on its notes is high, the premium that would have to be imposed to make the program costless to the federal government might be fairly high. Even if this risk is ignored, the federal government may want to charge a relatively high premium to discourage other potential claimants on this refunding service. From the standpoint of the city, the resulting rates may be desirable since they would doubtlessly be lower than those currently being paid. Another advantage of a plan involving direct purchase of the city notes by the federal government would be that the loan could be maintained as a short-term obligation which could be shifted quickly back into long-term municipal bonds when investor confidence in the city was rebuilt. The period of intervention in the city's affairs by higher levels of government thereby could be minimized.

Bond Guarantees. Another policy option that is very similar to the refunding operation just discussed is federal guarantees for New York City bonds and notes. This option would involve no additional tax expenditure costs because the federal government receives no tax on interest income from New York City debt whether or not it is guaranteed. The extra expenditure in this option essentially would be an insurance premium, stemming from the possibility that the federal government might have to pay off New York City's debt if the city was unable to meet its obligations. Of course, the federal government could charge New York City for this guarantee in much the same way the FHA or FDIC charges its clients. But again, without assurances of fiscal responsibility, this surcharge might need to be quite high.

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1. Alternatively the Federal Reserve could finance such purchases by increasing the money supply.

Without any sort of premium charged for these guarantees, the market rate of interest on federally-guaranteed, tax-exempt bonds or notes would be significantly lower than the rate now paid by even the highest rated (Aaa) municipalities. Therefore, it could be expected that all jurisdictions would want to avail themselves of this guarantee unless rather stringent conditions were placed on those governments receiving the benefit. Yet, such restrictions might be viewed as inequitable, because fiscally "responsible" jurisdictions would be forced to pay higher rates than those that had proven to be "irresponsible" and, thus, received the guarantee.

On the other hand, if all jurisdictions could obtain the guarantee, there might be a dramatic increase in municipal borrowing since the demand by municipalities for funds increases as interest rates decline. This would increase the inefficiency already caused by the artificially low price paid by municipalities for capital. A guarantee "premium" or a requirement that federally-guaranteed debt be taxable or a combination of both would increase the cost of borrowing to municipalities, thereby reducing demand for this mechanism and counteracting any temptation to borrow for projects with a low rate of return.

It is important to realize that federal bond guarantees, an agreement to federally-refund New York's debt or other similar policies could provide large capital gains to present bondholders. New York City securities have been discounted by the market to the point that they now have tax-exempt yields of approximately 11 percent. The rate of return on federally-guaranteed, tax-exempt issues would be less than 5 percent. Hence, the market value of long-term New York bonds could roughly double as soon as either federal plan were put into effect. With capital gains (or reduced capital losses) on the order of \$5 billion at stake, it is clear that the pressure for federal guarantees or refunding will be great from those who stand to benefit. One way of eliminating such gains -- if that were considered desirable -- would be to require that all New York City bonds be replaced with new issues that yielded a return of 5 to 7 percent after taxes on their purchase price (not face value). Of course, such a requirement would deny recent bond purchasers the profit most expected from risking their capital in a very uncertain security.

Reinsurance of Municipal Debt. Another suggestion for federal government action is the establishment of a federal reinsurance agency to guarantee all or part of the losses that bondholders would incur from default on state or local bonds. One current proposal would establish a federal insurance agency that would reinsure bonds that have already been insured by private bond insurance companies and insure bonds of state local assistance agencies.<sup>1</sup> It is the second of these provisions

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1. See S. 2372.

that would be relevant for New York City, since MAC fits the definition of a state local assistance agency. Since the proposal provides that insurance will be for only 75 percent of losses, it would amount to a partial guarantee of MAC bonds, but one that significantly reduces their riskiness. This reduced risk presumably would allow MAC to reenter the market and float bonds at lower rates of interest. This scheme would represent a less favorable alternative from the municipalities' standpoint than a bond guarantee in two respects. First, the municipality would have to set up a state local assistance agency to gain access to the federal guarantees; this would probably involve some loss of local control over finances. Second, partial guarantee of losses would result in a higher rate of interest than a total guarantee. It should be realized that most of the discussion dealing with federal guarantees applies equally to federally-insured debt and visa versa. For example, federal guarantees can be partial and large capital gains could result from a reinsurance program.

Given the experience of the last ten years, during which time New York City has accumulated \$3.3 billion in operating deficits, any decision to refund, guarantee, or reinsure city debts would probably be accompanied by some control -- directly or indirectly through the state -- over the city's expenditures and revenues. Without such control, this financial help might be considered a license for further deficits by city officials, and at the very minimum an invitation for other cities to build up deficits for the federal government to assume. Furthermore, federal intervention in the issues of local taxation and expenditures violate a long-standing tradition of separation of responsibilities. Therefore, the expected consequences of the laissez faire stance now taken by the federal government must be considered sufficiently serious to warrant changes in that stance and the inevitable federal involvement in New York City's politics and budgetary decisions.

Shifting Financial Responsibilities. A final set of policy alternatives that could help New York City would be to shift some major fiscal responsibility now borne by the city to the federal government. The most frequently mentioned options along these lines are a federal takeover of welfare and replacement of the Medicaid system with a National Health Insurance Program. Realistically, these alternatives must be looked upon as options that could assist the city over the long run but could not provide salvation from its immediate problems. Any effort along these lines would entail complex nation-wide shifts and would involve higher federal taxes.

Summary. The policy alternatives have been discussed in this report, but they could, of course, be combined with each other to form a package of programs that would assist the city. In fact city, state and federal programs that individually might offer inadequate assistance can be grouped together in ways that provide realistic solutions to the

city's immediate dilemma. There are a large number of conceivable combinations that could be constructed from the alternatives listed in the chart below. One illustrative possibility would be to establish a system that requires:

- . the city to reduce expenditures, raise taxes and conform to the other strictures of the Financial Emergency Act,
- . the state to gradually, over a five-year period, assume the full local fiscal burden for welfare-related programs and,
- . the federal government to establish a new taxable, federally-guaranteed class of municipal bonds that would be issued to cities through state governments which would be required to certify that the recipient of the guarantee was reforming its fiscal practices and adhering to a strictly balanced budget.

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City	<ul style="list-style-type: none"> <li>A. Expenditure reductions</li> <li>B. Tax increases</li> <li>C. Adoption of sound fiscal practices</li> <li>D. Management reforms and increased productivity</li> </ul>
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State	<ul style="list-style-type: none"> <li>A. Increased direct aid</li> <li>B. Borrowing in behalf of the city</li> <li>C. Assumption of the fiscal responsibility for some major city service (e.g. welfare, the university, etc.)</li> </ul>
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Federal	<ul style="list-style-type: none"> <li>A. Direct aid (e.g. Anti-recession Act, increased general revenue sharing, etc.)</li> <li>B. Direct loans</li> <li>C. Bond guarantees</li> <li>D. Bond insurance or reinsurance</li> <li>E. Assumption of the fiscal responsibility for some major city service. (e.g. National Health Insurance, Welfare Reform, etc.)</li> </ul>
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## VII. CONCLUSION

The focus of this paper has been largely on the immediate crisis facing New York City and the alternative policy responses to this situation. However, the crisis will only be delayed temporarily unless the underlying causes of the city's fiscal difficulties are addressed. While it may be comforting to believe that these problems can be handled by the city alone, this probably is not the case. Certainly efficient management, strict accounting procedures, and the introduction of new technology can help, but such measures alone will not balance New York's budget and pay off a substantial portion of its accumulated short-term debt. Substantial service cutbacks and tax increases will be required to accomplish these objectives. Yet such actions will make the city a less attractive place in which to live and probably will hasten the exodus of middle- and upper-income families and commercial and industrial establishments. This, in turn, will undercut the city's ability to support even a reduced level of services.

Given these forces, it is probable that the underlying problems facing New York, as well as a number of other large, aging cities, can be dealt with effectively only by the states or by the federal government. Unless one is willing to consider policies that would redistribute the low-income populations among other jurisdictions, or would redraw city boundaries so as to encompass suburban areas, or that would radically equalize income, the main alternative left for addressing the cities' problems is to relieve the city of some major portions of its current fiscal responsibility. As has been mentioned previously, New York City's situation would be aided immensely if the state or the federal government assumed the burden now borne by the city for welfare and related services to the poor.

Senator JAVITS. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Eagleton is not a member of the committee but is extremely interested in this and he's asked if he could sit in on it and nobody on the committee objects and with unanimous consent he may ask some questions.

Senator EAGLETON. Thank you very much, Mr. Chairman. I will be very brief and just ask two questions of Mr. Millstein, both rather specific.

Mr. Millstein, if New York City were to default, would that not give the city an opportunity to renegotiate its union contracts and/or its pension agreements or both?

Mr. MILLSTEIN. Not under the current State law. It would need an amendment of the Federal law, chapter 9, which we don't have, which might then enable the city to do it. But under current State law, no.

Senator EAGLETON. That leads me to my second question which relates to chapter 9. Should not the Congress at the very least take a long, hard look at chapter 9, not in the words of Mayor Landrieu, to make it simple and easy for a city to go bankrupt, but rather to make it realistic, if conditions warrant, for a city to reorder its debts? That is, shouldn't we take a look at chapter 9 with a view not only to New York but also Buffalo, Detroit, and perhaps other municipalities so that we could resolve some of the uncertainties that you have previously articulated in terms of priority of debt payment?

Mr. MILLSTEIN. I think the answer to that is clearly yes. The work has been going on on the House side for almost 3 years. The National Bankruptcy Commission has been working on it. The referees have been working on it and that work is virtually in fruition. That work should go on.

Senator EAGLETON. Thank you, Mr. Chairman.

The CHAIRMAN. I just have one question I will ask because of the time. I want to ask Mr. Millstein or Mr. Axelson or Mr. Beame, whichever one feels they can answer it. I was told last night by a highly responsible official in the State again that some \$20 billion is available to New York in its pension funds overall, New York State and New York City, and that if the will were there that it would be tapped to the extent of the \$4 or \$5 billion necessary.

Now can you answer that challenge that I got from this official?

Mayor BEAME. Well, in terms of the State, of course, I couldn't give you an answer as to just what their pension responsibilities are.

With respect to the city pension funds which amount in the neighborhood of about \$7 billion, they probably have been tapped very close to three-quarters of a billion or perhaps a billion. There is a question, too, the trustees of those systems, who are of course independent, have with respect to the percentage of one investment in terms of a prudent investment of the different securities that they would have.

Secondly, in order to unload those kind of securities rather to get that kind of money, I think would cause a complete disturbance in the market nationally.

But I do want to say that we have gotten fine cooperation from the city employees who under the law make up half, an equal number of the trustees of each of these systems. The question which has constantly been raised is this question also of the prudent percentage of investment of a portfolio plus the effect of any unloading to the extent which

is talked about would have on the whole market and the tremendous losses which would have to be taken in order to get at that.

The CHAIRMAN. All right. Before I yield to Senator Brooke, I do have one other question.

We have had consistent testimony from the Secretary of the Treasury and also from the municipal financial experts who testified before our committee that the accounting system in New York is not standardized; it's not clear; and I must say that the staff of this committee had great difficulty in deciphering just what was the situation in New York very clearly when the material was made available to it from your release on Wednesday or Thursday of this past week.

Do you plan to clarify and simplify your accounting procedure? Because I do think if we are going to get action on the part of the Congress we have to have this just as clearly as possible precisely where the reductions are going to come, just where the revenue is coming from so we have a clear financial report to know what we are talking about.

Mayor BEAME. Yes. And I'd like Deputy Mayor Axelson to speak on that. We have documents which were brought here to the committee to clear up that question.

Mr. AXELSON. Under the legislation passed earlier this year the city is mandated to change its accounting systems and to improve them and to make them conform to the accounting systems of the State as prescribed by the State comptroller. Those processes are underway and the requirement is that the accounting be on that basis and that they be in a position to be audited on that basis in the fiscal year 1977-78.

The CHAIRMAN. This is the year 1975 and we're told by many people we should act rapidly, including the Chairman of the Federal Reserve Board. I think that advice is right. We have a deadline of December 1.

Our problem, of course, is whether we're going to get a clear, understandable, simple report of what your situation is in the next few days. As a matter of fact, as I announced, we are going to try to decide one way or other so you will know this week, probably by Wednesday night, and if we're going to do that we'd like to get information over the weekend just as clearly as you can give it to us.

Mr. AXELSON. We have complete information. We'll be happy to make it available and work with your staff on it.

Senator BROOKE. Thank you, Mr. Chairman.

Mr. Axelson, when you answered my question about whether default would free up sufficient funds to meet your payroll and pay for essential services, you indicated that it would not. Now I have talked with the Banking Committee staff on this. They have shown me some figures supplied by the New York State Budget Office which indicate that if New York City were freed from paying debt service—and I take it that you did not include debt service in your response—it would have more than enough to meet its expenses on an annual basis. It's a rather complex issue to get into at this time, but I shall ask our staff to submit those figures to you, and I would appreciate it if you would comment on them for the record. I think it might be very important to this committee.

Mr. AXELSON. I would be happy to do so. I don't know what figures you're referring to, but we do have comparable figures based upon

the financial plan which has been submitted to the Emergency Financial Control Board and I will be very happy to go over that with them.

Senator BROOKE. Thank you.

Now, Mayor Beame, you have spoken about the very deep cuts you're going to take in New York City's budget which will require layoffs and substantial curtailment of services, in order to have a balanced budget within 3 years. So far as the ordinary citizen of New York is concerned, won't the conditions which you must meet to obtain a guarantee be as bad or worse than the effects of default?

Mayor BEAME. Well, I think we're going back over the same argument which we gave; namely, that I think a default will not solve the problem. It won't get us back into the market for many, many years. As a matter of fact, in Detroit I understand that they didn't get back for about 8 years and they were able to be helped by the State. In New York City, of course, our problem is so much larger than the State's and I don't believe that default will be a better solution to our problems of services to the people of the city because we're going to have to cut much more deeply than we already have.

I want to emphasize that I had cut this budget by a billion dollars, laid off \$400 million in personnel and if we're going to—now we're going to do another \$200 million and have to provide further cuts—to be faced with an additional cut of almost a billion dollars in the next several months, it would in my judgment be extremely damaging to the city and to the people.

Senator BROOKE. That's precisely my question. You're going to have to make even more cuts than you have already made in order to qualify.

Mayor BEAME. Not if we get the right to go into the market in order to be able to borrow like every other city today can do. For example, we did have to pay for capital improvements out of our tax revenues because we're not able to get into the market. Now that kind of expenditure would not have to be made.

Last year I believe we spent \$800 million for capital improvements which normally would have come out of bond money which we now have to take out of tax money and perhaps we have another \$400 or \$500 million in this first quarter of this year.

Senator BROOKE. Mayor Landrieu, I quite agree with everything contained in the summary of the Congressional Budget Office's report which you referred to in your testimony. It's an excellent summary and I think that's the direction in which we should be moving, federalizing welfare, et cetera; but in that same report, on page 2 of the summary, appeared the following:

Before a fiscal reorganization plan could be successfully implemented, some loss would be suffered by those who were forced to sell their New York securities, but over the long run the city's obligations are very likely to be met. The short-run impact of the default on banks would probably be moderated by the announced policies of the Federal Reserve System and the FDIC.

Now I don't want it to appear that anyone who asks any questions of you is a hater of New York. I love the city. Don't tell Boston this while we're winning the series, but I think it's the greatest city in the world. But our first obligation is to the Federal Government and to the country as a whole.

I think even Mr. Mulroy when he said his county governments would be in favor of this—I wanted to be sure you're in favor of doing something not only for New York but for everybody else. Isn't that correct?

Mr. MULROY. Not unless they're willing to accept serious constraints and they are in dire financial trouble.

Senator BROOKE. Yes, but you're concerned about counties throughout the country that might be in a similar situation at some time, are you not?

Mr. MULROY. No, sir. I am concerned primarily about the health of the municipal bond market and the fate of the municipalities in this country in that market.

Senator BROOKE. Fine. Let's go to that right now and I'll ask this question of Mayor Landrieu.

Mr. Mayor, I find it difficult to understand just how guaranteeing New York City's debt will make it any easier for other governmental entities to borrow, including your city and Mr. Mulroy's counties. Certainly investors would know that the only reason New York City has not defaulted is because of a Federal guarantee. This is not going to be any surprise to them. It's not going to be concealed from them.

How does a Federal guarantee for New York City securities increase the marketability of securities issued by other cities, States, or counties unless the securities issued by those governments are also guaranteed by the Federal Government?

Mayor LANDRIEU. Senator, all I can say to you is this; that there's an enormous difference between almost going bankrupt and going bankrupt. New York City almost defaulted yesterday but the fact of the matter is they didn't. You almost get hit by a car when you cross the street but the fact is you ain't dead; you're still living.

Now until such time as a major city goes into bankruptcy it seems to me that the market works on certain assumptions; that their bills are going to be paid; that they have a contract; that out of the first revenues of the city the money which that bondholder has loaned to the city is going to be repaid. Those are basic assumptions. We work on these every day.

The fact is that you and I sign a contract with someone as a post facto matter is not going to alter that contract. You take a dollar from someone because you know you can exchange it based on faith. You never counted the gold in Fort Knox, but it's on faith.

Now all of a sudden the entire faith behind municipal bonds is shattered. I don't know what the effect of that is, but I would tell you I would be greatly concerned.

Senator BROOKE. Because of the New York situation only?

Mayor LANDRIEU. Not only because of that, but principally because of it, and because of the move to say let us now liberalize bankruptcy laws so that those who loan money to municipalities hereafter will not have the assurance of the first avails of tax funds. Let's set the priorities so that it may not come before the payment of firemen and policemen and I can tell you that the people who loan my city money feel that they are going to be paid before anything gets done in the city. It's the first call on the revenues. But now we're saying in order to relieve the Nation of the problem of New York, let us alter that and bankruptcy will alter that, and I suggest to you that all people who

want to invest are going to ask themselves, "Do I really in fact have the first call?" Because that question will be answered in this procedure. It ultimately costs all of us more money.

Senator BROOKE. But even if they go into bankruptcy, the bondholders ultimately will receive their money back.

Mayor LANDRIEU. Yes, sir, but let me say this to you: That's like you going to the bank and I don't do much borrowing at the banks and I told the bank to call on my note today but don't worry about it; I'm going to pay you in 60 days; and that fellow says, yes, but I owe somebody else and he owes somebody else. It isn't that simple. There are many people who have those bonds, I would imagine, posted as security for loans they have at banks.

Senator BROOKE. Last Wednesday Pennsylvania offered \$500 million notes of sale and, according to the Wall Street Journal, Pennsylvania's notes attracted such heavy demand that they were quickly marked up in price so as to reduce their yield to 4.9 percent from an original 5 percent. The same day, again according to the Wall Street Journal, excellent quality also was represented by Georgia's \$48 million of new bonds. They were priced to yield between 4 percent in 1976 and 6.8 percent in the year 2000. That 6.85 percent was only 0.2 percentage points more than 6.65-percent return on similar 25-year-old bonds sold by Georgia in August.

Now don't these figures indicate that New York's problems are not wrecking the municipal bond market? Isn't it possible that investors are just becoming more discriminating?

If the Federal Government were to come to New York City's aid as a part of the aid program, would you say the banks would then be willing to increase their holdings of unsecured New York City bonds?

Mayor LANDRIEU. I don't know how many questions you asked me.

Senator BROOKE. Pick the one you like and answer that.

Mayor LANDRIEU. I'll try that. But it seems to me you mentioned States.

Senator BROOKE. Yes.

Mayor LANDRIEU. I didn't see any major city bond issues mentioned there. Why don't we try St. Louis and Detroit?

Senator BROOKE. It was said that the bond market was skittish and that no one was able to get bonds. What we're trying to find out is whether where you have good management, where you have some entity—not necessarily a city or county, but a State as well—on which you can have confidence the bond market is there—

Mayor LANDRIEU. That's correct, Senator, but the fact of the matter is that cities aren't States. We don't have sovereignty and that's part of the issue that's being made here. Cities wouldn't be in the posture in which we find ourselves if we were in fact sovereign. We are creatures of the State. We are bound by that Federal-State-city relationship and we are mandated to do things which you could not perhaps otherwise mandate a State to do.

So a State security ought to be more secure, but tell me about the Detroit's and St. Louis and New Orleans and Atlanta's.

Senator BROOKE. You tell me. Are they in trouble at the present time?

Mayor LANDRIEU. Yes, sir, not because they have borrowed to meet current operating expenses, but read that report that comes from the

congressional study committee. There isn't a major city east of the Mississippi River that doesn't have serious difficulty now and those difficulties are going to grow. The fact of the matter is that because we do not borrow to meet current operating expenses, we all have balanced budgets except New York, but that doesn't mean we have not been reducing services. We are picking up garbage twice a week now. We used to pick it up five times a week. Perhaps in 3 years we will pick it up once a week. We used to pick it up five times a week and didn't charge for it. Now we pick it up twice a week and charge for it.

Ultimately, you can only reduce your police and fire departments to a certain point beyond which the city doesn't become livable. It seems to me the tax burden New York City is bearing, \$1,600 a year on a \$25,000 home, an 8-percent sales tax—and Newark is even worse—that the people in the center cities are paying for what we are—we are paying for mandated costs by the Federal and State governments.

Senator BROOKE. Getting back to the other question now—and I agree we ought to federalize welfare and those kinds of social programs.

Mayor LANDRIEU. Let me just complete this, if I may, Senator, because it has to do with whether or not we shouldn't let the bond market go to preferential purchasers or at least to the preferential lenders. It doesn't do the people of my city any good not to be able to go into the market. It may do something to the discipline of the market to say, fine, you've achieving quality. How do I achieve quality when 40 percent of my people are under the poverty level? How does St. Louis achieve quality? Does that mean we don't borrow because we're poorer and older cities, although we have served the country for years? It's a national problem and I'm astounded at the way Congress and the administration has turned away from it.

Mayor BEAME. Senator, may I just supplement that, if I've got one of the questions you asked correctly as to how would a guarantee to the New York City bond help the other cities. I thought that was one of the questions which was raised in the many you asked. I think the answer is very simple. New York City today has a major share of the short-term market and the bond market. If there were a guaranteed bill, we have said that it should be a guarantee of a taxable obligation. If such a taxable obligation was then issued by New York City, it would not be in competition with the needs of the other cities and would, therefore, make the supply among the other cities so much less for them to compete with and, therefore, undoubtedly result in a better rate of interest to them.

Senator BROOKE. Well, I don't want to belabor it, but I keep referring back to the Congressional Budget Office—you have said that New York is not that far out of line as far as salaries are concerned. In the report, on page 18, it states that what little reliable evidence there is seems to indicate that New York City provides its employees with considerably more in the way of fringe benefits, pensions, health insurance, and so forth, that are offered the employees of other large cities. That's a matter we're going to have to deal with. I'm sure you're aware of that.

Then it goes on to say:

While the New York situation in many ways does not differ markedly from other large central cities—

As you have suggested—

some of its problems are clearly not shared with other cities. First, there's New York City's debt situation. On a per capita basis, the city has far more debt outstanding than do the local governments providing services in the other central city areas. This is particularly true of short-term debt in which New York stands alone in its needs continually entering the market to "roll over" large quantities of notes. Second, New York, as far as can be told, is the only major city that has chronically run a large current operating deficit in both good and bad economic years. Finally, as was mentioned previously, New York revenues and expenditures are much more sensitive to the ups and downs of the business cycle. All of these peculiar aspects of the New York situation should make one pause before concluding that the city's crisis is but the forerunner of those that will occur widely elsewhere.

Mayor LANDRIEU. Senator, I have tried to say over and over again that I know of no other city in the United States, save perhaps one which I can't even name, that is borrowing to meet current expenses. We do not have that problem. Every city has a system of funding that requires us to balance our budget. You do not have to balance the Federal budget. We balance our budget. If you cut my revenues in half today I would balance the budget next year. I'm mandated to do so.

The problem is that the cities expenses are increasing more rapidly than are its income and it's a simple matter stated in the report, the middle and upper income people are moving out of the cities. Jobs are leaving the city. The poor and the elderly are moving into the center cities. Suburban areas are growing and center cities are decreasing in population. I don't think there's much to argue about with that.

Senator BROOKE. I don't disagree with that at all. We know it. Are you saying the Federal Government ought to be in the business then of guaranteeing bonds for all municipalities?

Mayor LANDRIEU. No, sir.

Senator BROOKE. Because the bill before us, the so-called Proxmire draft bill does not address itself to anything but the city of New York.

Mayor LANDRIEU. No, sir, I don't think you're ever going to find another city—

The CHAIRMAN. I have no bill that I have introduced.

Senator BROOKE. The bill that we are going to mark up is the bill I was talking about.

The CHAIRMAN. This is not my bill.

Mayor LANDRIEU. I don't think you're going to find another city in this country—I can't imagine any mayor or any councilman anywhere wanting to place themselves in the position in which New York has now found itself and let me assure you that it wouldn't happen anywhere else. It would not happen in the State of Louisiana or the State of Texas. If this were a city in the State of Louisiana, the State would appropriately have moved to salvage that situation, but then—

Senator BROOKE. Why doesn't New York State do it?

Mayor LANDRIEU. For a simple reason. The budget of New York City is larger than the budget of New York State. My State's budget is small, only \$2.5 billion, but there are cities whose budgets are \$10 million.

Senator BROOKE. I understand that Buffalo is close to it.

Mayor LANDRIEU. Is close to what?

Senator BROOKE. New York City. It may be next in line. That was testified to the other day. It's a possibility.

Mayor Beame—and this is my last question because we do have many witnesses—to what extent can additional revenues be raised by

a commuter tax. You have a lot of people I'm sure that come into New York City and use your city and go back to their homes—perhaps even some of your firemen and your policemen don't live in the city of New York. I know a little about New York City's internal problems. Many of your city employees live in Nassau and come in and get their salaries and go back and don't participate in the city; they don't spend much money in the city. Has anything ever been done by New York City or New York State to try to correct this situation?

Mayor BEAME. Yes.

Senator BROOKE. What?

Mayor BEAME. First, I'd like to say I have had bills introduced in the legislature to require any employee to be a resident of the city. Those bills were not able to be passed.

Second, we have a commuter tax in New York State—at least the city has, but that commuter tax is only at one-eighth the tax on our own residents and we think it's completely unfair. But as I indicated earlier it's a question of reality. It's a question of politics. We cannot get that commuter tax because one of the houses of our legislature has great representation in the commuter areas and is not Democratic—and I say that with a capital "D".

Senator BROOKE. I saw you building up to that, being a Republican.

Mayor BEAME. And we haven't been able to get support for it. We have asked for it every legislative session and the best we could have gotten is the one-eighth.

May I add one thing, Senator, and I think just to emphasize some things that Mayor Landrieu indicated, there's only one city in the country other than New York City which pays for welfare. I think there's only one other major city—and that's in a lot of numbers of cities by the way—that pays for education. I think that's Baltimore. In every other city involving welfare, it happens that it's either paid by the county or the State.

With respect to education, as you know, there are separate school districts, separate taxes which has nothing to do with the government. Now if we want to have the same kind of situation, somebody take over our welfare and it should be the Federal Government, and I'm glad to hear you agree with it; and if we had a separate tax for school taxes which has nothing to do with the government of the City of New York, which gets its money out of one pot, our budget would be cut from its \$12.3 billion down, \$5.3 billion, reduced by 40 percent.

Senator BROOKE. I think that's one of the most compelling arguments that the State has not done all it could do.

Mayor BEAME. We are going to get after the State if we can get both houses to agree on giving aid. Now one house did pass aid to New York City. The other house didn't.

Senator BROOKE. Thank you, Mr. Chairman. Thank you, Mr. Mayor. The CHAIRMAN. Senator McIntyre?

Senator McINTYRE. Mayor Beame, we now come to a point in fact where the securities of New York City and all its agencies and many of its political subdivisions, not just New York City, for all practical purposes, are being boycotted by the national investment community. Would default by the city actually help the State and its agencies?

Mayor BEAME. It's the general opinion, not only in State govern-

ment, but what we hear from the financial community, that the State would be in a very serious financial condition if New York City defaulted; that it could conceivably create that kind of problem for New York State.

Senator MCINTYRE. So default would not help?

Mayor BEAME. No. I think it would hurt.

Senator MCINTYRE. Thank you, Mr. Chairman.

The CHAIRMAN. Well, gentlemen, thank you very, very much for an impassioned expression of your position and a most persuasive one. We are very grateful to you. You have made a fine record.

Our next witnesses will be the Honorable David H. Rodgers, mayor of Spokane; and the Honorable Richard Carver, mayor of Peoria. Gentlemen, we have many witnesses and we don't have much time, so I hope that you will come to order as soon as we can.

I understand that mayor Carver cannot be present and he has a very short statement, and I understand you will read it on his behalf.

Mayor Rodgers, we are very happy to have you here, and Senator Garn is very sorry he couldn't be here, but he's asked Senator Brooke to introduce you.

Senator BROOKE. Senator Garn would have said this if he could have been here: "Mayor Rodgers, Mr. Chairman, I'm very sorry that commitments in Utah during the recess prevent my attending this hearing on the committee on the issue of Federal assistance to New York City. I am very pleased that these hearings provide the opportunity for all views to be expressed. I am especially pleased whenever the chief executive of one of our nation's cities is present at congressional hearings. I believe those elected mayors and councilmen to be in the front lines of government where they deal face to face with the real problems of our country. One of those appears before the Committee today and is here in response to an invitation from the Committee which I initiated. He is Mayor H. Rodgers of Spokane, Washington, elected first in 1967 and reelected twice since. Mayor Rodgers' present term expires in 1978. He has been a progressive and active mayor and has successfully fought the battle of balancing his city's budget during his years in office, including guiding them to the production of the world's exposition last year. Mayor Rodgers is here to make his own statement on the issue before the Committee. I know nothing of his position except that we are in agreement on the necessity of demanding fiscal responsibility of our elected officials and making them accountable for their actions. He speaks for himself and I assure the Committee that he's representative of a great many of his fellow mayors around the country. I thank him in advance for his willingness to appear here today and discuss his view of this important issue. He also has with him a statement from mayor Richard Carver of Peoria, Illinois.

The CHAIRMAN. Mayor Rodgers, go right ahead.

#### STATEMENT OF DAVID H. RODGERS, MAYOR OF SPOKANE, WASH.

Mayor RODGERS. Mr. Chairman and Distinguished Members of the Committee on Banking, Housing and Urban Affairs, I'm Mayor David Rodgers of Spokane and am most appreciative of the invitation to appear before your honorable presence.

If I may, I will read a one-page statement that Mayor Carver dictated over the phone and asked me to read it for the benefit of the Committee. I quote Mayor Carver.

**STATEMENT OF RICHARD CARVER, MAYOR OF PEORIA, ILL.**

"It is my position that the Federal Government is faced with two alternatives. The first is to guarantee a portion of the debt of the City of New York in order to provide them with sufficient cash flow to meet their obligations or, second, to take no action and allow the city of New York to go into receivership. I prefer the second, to take no action and allow the city of New York to go into receivership. I prefer the second course because it will then become mandatory for the city to bring its expenditures into line with income.

"My position is predicated on the conviction that a 'bail out' would lead every city and State, as well as municipal bond investors, to believe that, in the event they are unable to service their own debt, they can rely on the Federal Government to 'bail them out.' My position also assumes the probability that the bondholders will not lose their money, but rather will be paid on a deferred basis."

That's the end of his quotation and Mayor Carver also asked to place in the record the position of the board of directors of the Illinois Municipal League. The board passed a motion, introduced by Mayor Carver, to the effect that no emergency assistance be given the city of New York unless the city had first demonstrated fiscal responsibility and the proven ability to repay any debt that the Federal Government might guarantee.

That's the end of Mayor Carver's comments.

The CHAIRMAN. Fine. All right, sir.

Mayor RODGERS. I will proceed now with my own comments.

The CHAIRMAN. Go ahead.

Mayor RODGERS. An unconditional "bail out" of New York City or any other city by the Federal Treasury would be "an invitation to irresponsibility" to every local government and public employee union in the country. Such action would, in effect, condone and freeze into the system the excesses which have led to the present crisis. I am assuming that no one is seriously considering such action.

A conditional "bail out" requiring commitments to austerity and to sound fiscal management as a precondition of Federal guarantees would seem to require a solution by New York City before Federal help was actually delivered.

On one hand, if New York City could qualify under realistic preconditions, one has to wonder if Federal help is really needed.

On the other hand, if the preconditions have no substance and are simply an excuse to gloss over a Federal handout, we would then have issued that "invitation to irresponsibility" to public officials, creditors, and public employee unions across the land.

The long-term implications of big brother standing in the wings to bail out debt-burdened cities and their creditors or to underwrite irresponsible demands of public employee unions is a very, very serious and distressing concept.

As I see it, there are three roots to this crisis. They are as follows:

1. Financial institutions have loaned money to people who cannot pay it back.

2. Public employee unions have forced wages, fringes, and, particularly, pensions that the taxpaying public is unwilling to pay and, I am afraid, in some cases, unable to pay.

3. Public officials are unable or unwilling to say "no" to unreasonable demands on government.

The responsibility for resolution of these problems properly rests with those who created them. The realistic effect of Federal intervention would be to postpone and gloss over the current problems and set up another crisis down the road. Even worse, it would condone irresponsibility and increase the probability of similar problems all over the country.

Federal concern in this matter should be one of containment. Containment of the financial impact to the parties currently involved and containment of the excesses that have generated this crisis.

It is my impression that most competent authority discounts the possibility of a general financial collapse should New York City default. However, if people knowledgeable in the financial community convince the Congress that this is a possibility and, if some new Federal legislation is needed to effectively contain the impact to a New York arena within which the parties at interest could resolve their problems, such legislation would be in the public interest.

Reduced to its essentials, my plea is that the Congress recognize the problems that will be created for hundreds of mayors throughout this land if Congress should establish the dangerous precedent of underwriting the excesses that brought on the current crisis.

Many cities have defaulted during this century, yet their basic services were maintained and they are viable communities today. I am sincerely convinced that the union officials, the creditors, and the public officials of New York City, along with the tremendous and conscientious efforts demonstrated by the State of New York can resolve their problems without involving the remainder of the Nation.

Again, thank you for the opportunity to be heard.

I will do my best to answer your questions.

The CHAIRMAN. Thank you very much, Mayor Rodgers, for a forceful and effective statement. You seem to be on the basis of the presentation we had from Mayor Laudrieu pretty unique. One out of 13, I think, was the way he put it. You said the executive committee of the U.S. Conference of Mayors met and adopted a resolution supporting assistance in New York, by a 13-to-1 vote. How do you answer that? Are you just speaking for a small minority of mayors or do you think this board is not representative?

MAYOR RODGERS. I think I probably speak for the majority. When I speak of the majority I am talking about every mayor in the country. The board of the National League of Cities was polled, I think, by telephone. I am not on that board. I think the true feeling of the mayors of this Nation will probably be determined the first week in December, when the National League of Cities holds its meeting in Miami. At that time, if this issue has not been resolved, I am confident that it will be a matter of considerable interest and surely an interesting issue of some—

The CHAIRMAN. Mayor, what evidence can you give us? What hard, clear evidence can you give us? We have the board of the League of Cities and the League of Cities is a representative group of mayors.

They are chosen, I understand, on a representative basis and they voted on this, they were aware of the situation, and they voted 13 to 1 in favor. You come before us and say you think a majority of mayors don't take that view.

Some people may say most of the people in the country don't support it. The only poll I have seen shows the majority of people do support assistance for New York.

Can you give us any evidence of your horseback opinion? It may be right.

MAYOR RODGERS. That is what it is, a horseback opinion. A conservation with a few other mayors. I think Dick Carver. I think what we have is a board of directors that has been propositioned to take a position. They have taken a position and taken by telephone poll. I am not going to say that it is not the true position of the National League of Cities, but I think that, as I say, the really true feeling will be demonstrated when the National League of Cities convenes.

THE CHAIRMAN. Now, Mayor, will you—in the opening part of your concise statement you said that a bailout, for New York City or any other city would be an invitation to irresponsibility. And I couldn't agree with you more. I think everybody will agree with that. This will not be unconditional, however. Then you go on to say if the conditions require sound fiscal management they wouldn't need it.

I have become persuaded that they would need a guarantee by the Federal Government, with the soundest kind of fiscal management from now on to get access to the market to meet their short-term needs over the next 3 or 4 or 5 or 6 months. They have adjusted a deficit in the next 6 months, depending on how you figure it of at least \$3½ billion.

If they can't go to the market where do they get the money? The guarantee would enable them to go to the market, but on the condition that they work on a reduced budget, that they make no capital expenditures not approved by a supervisory group, conditions which seem to be to me to be important.

Now, what is your answer, is this a timing problem?

MAYOR RODGERS. If I properly understood the previous testimony, the critical problems, employee wages, basically seem to be the critical type problem, could be taken care of. These matters could be worked out. And it is the creditors who would have to wait for their money.

My position is, this matter should be worked out between the creditors, the public employee unions and the public officials. In this case, and your question, the creditors are the ones who are going to have to wait for their money, during this period of time.

THE CHAIRMAN. Well, that opinion may be correct. But nobody knows. The contracts seem to provide that the creditors will be taken care of. The courts may decide that that would be the case. Mayor Beame indicated it was his best judgment, and, again, the mayor, since he is in a position to know more than the rest of us, he would have to curtail essential services and it may require a massive Federal assistance.

Now, do you feel confident that that will not develop, and, if so, why?

MAYOR RODGERS. I think when we get in the courtroom and the judge sets the priorities, there are going to be some deferrals of the creditors' payments. That is the only logical move.

The CHAIRMAN. But even if the turnover is deferred, even if all of that is deferred and not paid off, it is clear that there is a deficit in the operating budget of New York of some \$800 million over the next 6 months.

Now, how is that to be met if they have no access to the market? What do they do?

Mayor RODGERS. They have no money. I think they will have to be given short-term money some place.

The CHAIRMAN. That is it. That is all the guarantee would do. Finally, you talk about containment. I know that you in Spokane as well as in Milwaukee and the rest of the country are concerned about the effect that this might have on the security market. How could you argue that if New York defaults, the biggest city in the country, a city whose obligations have been rated rather high, and if the State of New York agencies default and they may well default, how can you argue that that wouldn't have an adverse effect on the cost of money to Spokane and other cities in the State of Washington?

Mayor RODGERS. It would affect us only to the extent, of course, that we go into the market. We probably will be in the market the next couple of years. However, I think the effect will be temporary, and Spokane's position in the market will depend upon Spokane's ability to repay its debts.

However, credit is good. We have excellent credit rating. I think we will stand on our own feet over the long haul. Temporary psychological impact of a New York default, if there was one, would be just that. Temporary and it wouldn't really impact us unless we happened to be in the market within a month or two after a default.

It may affect us by a couple of basis points, but I really think it is tunnel vision to look at this problem in terms of its impact on the market.

I think that this particular aspect of the debates is heavily overstated. Each city is going to stand on its own feet in the long run, as far as credit is concerned.

The CHAIRMAN. But Mayor Rodgers, isn't it true that people who invest in municipal bond market are likely to be far more cautious? A large proportion of all municipal obligations are now obligations of the city or State of New York and if you put your money in that market and you have lost, aren't you pretty reluctant to take that chance again unless you are very familiar personally, directly with the particular city involved?

It seems to me this would be bound to have a discouraging effect on bankers and other investors throughout the country. Generally bankers are experienced, expert investors, but I would think they would be chilled by this kind of a failure, for years to come.

Mayor RODGERS. No, I don't think so, Senator. When the Penn Central, the people that bought bonds in the Penn Central have a problem, but I don't think that is going to keep them from investing in Zerox, or something else, because of Penn Central. I think people who have bonds for New York have a problem, but people who have bonds issued by Spokane don't have any problems or Peoria or other cities. I think we will stand on our own feet. That problem simply doesn't concern me.

We may keep our own securities clean and sound and New York default is not going to have any significant impact on us.

The CHAIRMAN. We had testimony by the director of finance of the city of Philadelphia that if New York defaulted the cost would be about a billion dollars a year and for each year during the life of the securities issued over the next year or so with perhaps a \$10 billion cost for cities around the country. You don't think that would be a practical development?

Mayor RODGERS. No, I don't, Senator. I think we can stand on our own feet.

The CHAIRMAN. Senator Brooke.

Senator BROOKE. I have no questions.

Senator JAVITS. I have one question. What is your bond amount now?

Mayor RODGERS. \$7.5 million.

Senator JAVITS. What is your population?

Mayor RODGERS. 175,000.

Senator JAVITS. What proportion of that population is at or under the poverty level? Say, \$4,000 a year?

Mayor RODGERS. I can't give you that figure. I can give you an 8.2 percent unemployment figure.

Senator JAVITS. As contrasted with New York City's 12 percent, unhappily. May I ask you this one other question. When the \$20-odd million comes due, aren't you going to go into the market and refinance it or pay it off?

Mayor RODGERS. We will pay it off.

Senator JAVITS. You would pay it off. So your city will be debt-free?

Mayor RODGERS. Yes, sir.

Senator JAVITS. When?

Mayor RODGERS. Very shortly, about 10 years. I don't know exactly.

Senator JAVITS. You are able to do that?

Mayor RODGERS. Yes.

Senator JAVITS. That puts you in a radically different position from any other city in the country.

Mayor RODGERS. We did borrow some money to prepare the site for our world exposition, but we borrowed and paid it off in about 6 years.

Senator JAVITS. But you are not a city that is going in the market at all?

Mayor RODGERS. We are going to do some redevelopment. We will be in the market for \$2 or \$3 million in the next couple of years.

Senator JAVITS. But as far as city debt is concerned, you are not going in the market?

Mayor RODGERS. No.

Senator JAVITS. Thank you very much.

[Complete statements of Senator Garn, Mayor Rodgers, and Mayor Carver follow:]

STATEMENT OF SENATOR GARN ON INTRODUCTION OF  
MAYOR DAVID H. RODGERS, OF SPOKANE

Mister Chairman, I am very sorry that commitments in Utah during the recess prevent my attendance at this Hearing of the Committee on the issue of federal assistance to New York City.

I am very pleased that these hearings provide the opportunity for all views to be expressed. I am especially pleased whenever the chief executive officer of one of our nation's cities is present at Congressional hearings. I believe those elected mayors and councilmen to be in the "front lines" of government, where they deal face-to-face with the real problems of our country.

One of those appearing before the Committee today is here in response to an invitation from the Committee which I initiated. He is Mayor David H. Rodgers, of Spokane, Washington. Elected first in 1967, and re-elected twice since, Mayor Rodgers' present term expires in 1978. He has been a progressive and active Mayor and has successfully fought the battle of balancing his city's budget during his years in office, including guiding them through the production of the world's exposition last year.

Mayor Rodgers is here to make his own statement on the issue before the Committee. I know nothing of his position except that we are in agreement on the necessity of demanding fiscal responsibility of our elected officials, and making them accountable for their actions. He speaks for himself, and I assure the Committee that he is representative of the feelings of a great many of his fellow mayors around this country.

I thank him in advance for his willingness to appear here today and discuss his view of this important issue.

Statement by

HONORABLE DAVID H. RODGERS

MAYOR OF SPOKANE, WASHINGTON

Mr. Chairman and Distinguished Members of the Committee on Banking, Housing and Urban Affairs, I am Mayor David Rodgers of Spokane and am most appreciative of the invitation to appear before your Honorable presence.

An unconditional "bail out" of New York City or any other city by the Federal Treasury would be "an invitation to irresponsibility" to every local government and public employee union in the country. Such action would, in effect, condone and freeze into the system the excesses which have led to the present crisis. I am assuming that no one is seriously considering such action.

A conditional "bail out" requiring commitments to austerity and to sound fiscal management as a pre-condition of federal guarantees would seem to require a solution by New York City before federal help was actually delivered.

On one hand, if New York City could qualify under realistic pre-conditions, one has to wonder if federal help is really needed.

On the other hand, if the pre-conditions have no substance and are simply an excuse to gloss over a federal handout, we would then have issued that "invitation to irresponsibility" to public officials, creditors, and public employee unions across the land.

The long-term implications of big brother standing in the wings to bail out debt-burdened cities and their creditors or to underwrite irresponsible demands of public employee unions is a very, very serious and distressing concept.

As I see it, there are three roots to this crisis. They are as follows:

1. Financial institutions have loaned money to people who cannot pay it back.
2. Public employee unions have forced wages, fringes and, particularly, pensions that the taxpaying public is unwilling to pay and, I am afraid, in some cases, unable to pay.
3. Public officials are unable or unwilling to say "no" to unreasonable demands on government.

The responsibility for resolution of these problems properly rests with those who created them. The realistic effect of federal intervention would be to postpone and gloss over the current problems and set up another crisis down the road. Even worse, it would condone irresponsibility and increase the probability of similar problems all over the country.

Federal concern in this matter should be one of containment. Containment of the financial impact to the parties currently involved and containment of the excesses that have generated this crisis.

It is my impression that most competent authority discounts the possibility of a general financial collapse should New York City default. However, if people knowledgeable in the financial community convince the Congress that this is a possibility and, if some new federal legislation is needed to effectively contain the impact to a New York arena within which the parties at interest could resolve their problems, such legislation would be in the public interest.

Reduced to its essentials, my plea is that the Congress recognize the problems that will be created for hundreds of mayors throughout this land if Congress should establish the dangerous precedent of underwriting the excesses that brought on the current crisis.

Many cities have defaulted during this century, yet their basic services were maintained and they are viable communities today. I am sincerely convinced that the union officials, the creditors, and the public officials of New York City, along with the tremendous and conscientious efforts demonstrated by the State of New York can resolve their problems without involving the remainder of the Nation.

Again, thank you for the opportunity to be heard.

I will do my best to answer your questions.

Statement by  
HONORABLE RICHARD CARVER  
MAYOR OF PEORIA, ILLINOIS  
(As dictated by telephone)

Mayor Richard Carver of Peoria had hoped to testify in person, but could not arrange to be here at this time. He asked that his position be conveyed to the Committee. By telephone, Mayor Carver dictated the following quote:

"It is my position that the Federal Government is faced with two alternatives. The first is to guarantee a portion of the debt of the City of New York in order to provide them with sufficient cash flow to meet their obligations or, second, to take no action and allow the city of New York to go into receivership. I prefer the second, to take no action and allow the City of New York to go into receivership. I prefer the second course because it will then become mandatory for the City to bring its expenditures into line with income.

"My position is predicated on the conviction that a "bail out" would lead every city and state, as well as municipal bond investors, to believe that, in the event they are unable to service their own debt, they can rely on the Federal Government to "bail them out." My position also assumes the probability that the bond holders will not lose their money, but rather will be paid on a deferred basis."

Mayor Carver also asked to place in the Record the position of the Board of Directors of the Illinois Municipal League. The Board passed a motion, introduced by Mayor Carver, to the effect that no emergency assistance be given the City of New York unless the city had first demonstrated fiscal responsibility and the proven ability to repay any debt that the Federal Government might guarantee.

The CHAIRMAN. Thank you very much, Mr. Rodgers. You are a man of conviction and courage, and we are happy to have you here.

Our next witnesses will be a panel. This will be the last panel before we break for lunch, will include the Honorable Frank Wille, Chairman of the Federal Deposit Insurance Corporation; the Honorable James E. Smith, the Comptroller of the Currency; and the Honorable George Mitchell, Vice Chairman, Federal Reserve Board.

Gentlemen, we are delighted to have you. We apologize for the late hour.

Mr. Wille, I would hope that you gentlemen can condense your remarks, if possible, to 5 or 6 or 7 minutes each and put the rest in the record.

**STATEMENTS OF FRANK WILLE, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION; JAMES E. SMITH, COMPTROLLER OF THE CURRENCY; AND GEORGE MITCHELL, VICE CHAIRMAN, FEDERAL RESERVE BOARD**

Mr. WILLE. I should like to do that, Mr. Chairman.

Mr. Chairman and members of the committee, the FDIC is pleased to contribute certain factual information about potential impacts on the banking system of a New York City default for the committee's deliberations.

At the outset, I should note that the FDIC surveys have been limited to the Nation's 8,889 nonmember banks which the FDIC examines on a regular basis; that is, those insured banks, including mutual savings banks, which do not belong to the Federal Reserve System.

I might point out for the record that the FDIC generally does not examine the major money market banks which are members of the Federal Reserve System.

An accurate overall view of the banking system's exposure must, therefore, include an aggregation of the information developed by the Comptroller of the Currency and the Federal Reserve System for member banks, in addition to the FDIC's results for nonmember banks.

Second, the FDIC has sought to obtain factual information as to the holdings of various types of State and local obligations by nonmember banks and then to apply a variety of market assumptions to that information in order to quantify the full range of possible impacts on nonmember banks which might be caused by a New York City default.

The FDIC has no background of expertise, however, with which to evaluate likely market reactions in the event of a New York City default and must, therefore, caution the committee that its estimates of impact on nonmember banks are only as good as the assumptions on which they are based.

Any prediction as to impact requires two basic assumptions to be made.

One relates to the extent market values of State and local government obligations, particularly those issued by New York City, will drop if a default occurs, and the other relates to whether or not issuers of State and local obligations other than New York City will also be forced to default because market developments make it impossible for them to roll over existing debt in a timely manner.

The various market assumptions FDIC has made in preparing its estimates are clearly expressed later in my statement and are obviously fundamental to the FDIC's predictions.

Third, the FDIC has viewed the potential effects on the banking system to be serious enough to warrant contingency planning on a joint basis with the other bank regulatory agencies in three areas which relate to the safety and solvency of individual institutions:

(i) the examination treatment of defaulted obligations held by an insured bank,

(ii) the liquidity needs of particular banks whose holdings of affected State and local obligations may result in adverse depositor reaction, and

(iii) the capital needs of particular banks which suffer a loss of public confidence because of such holdings.

I am sure that all of us who are here today from the three Federal bank agencies would be glad to respond to any questions members of the committee may have concerning these contingency plans.

The FDIC surveys of nonmember bank holdings of selected State and local obligations have been conducted in three stages, and the results are detailed on pages 3 and 4 of my statement.

The first of these, which began in late July, was a review of the most recent FDIC examination workpapers for a selected sample of approximately 540 nonmember commercial banks, including all of the 44 nonmember commercial banks located in New York State, in order to estimate the relative percentages which each bank's holdings of New York City and New York State Housing Finance Agency obligations bore to that bank's total capital and reserves.

The sample of nonmember banks used in this initial survey—other than those in New York State—consisted of those nonmember banks which had been supplying weekly money supply data during a recent 10-month period ending in May, the purpose of which was to assist the Federal Reserve System to estimate more accurately the nonmember component of the Nation's money supply.

For that purpose, the sample had been reasonably representative of all nonmember banks in the country, but we recognized that its use for estimating nonmember holdings of the two types of issues in question might not produce estimates with the same degree of reliability.

In addition, the data derived would reflect different dates of examination, some of them more than 6 months before.

Nonetheless, this type of survey was manageable in numbers and could be made without undue publicity at a delicate time for New York City and the Municipal Assistance Corp. in their refinancing efforts.

This survey, which we recognized would result in a rough approximation only of the holdings of the Nation's 8,559 nonmember commercial banks, showed the following:

In New York State there were only 8 nonmember banks, smaller than \$100 million in total deposits, which held New York City obligations representing 25 percent or more of total capital and reserves, and only one nonmember over \$100 million in deposit size with a comparable exposure.

In New York State, if holdings of New York State Housing Finance Agency obligations were added to those of New York City, there were

only 12 nonmember banks, smaller than \$100 million total deposits, which had 25 percent or more of their total capital and reserves exposed, and only 4 nonmember banks over \$100 million in deposit size similarly exposed.

In New York State less than one-third of the nonmember banks appeared to have capital exposures between 10 and 25 percent, based on their holdings of similar obligations.

Nationwide it appeared that approximately 2.5 percent of all nonmember banks below \$100 million in deposit size would have holdings of New York City obligations in excess of 25 percent or more of their total capital and reserves, while only about 1 percent of the nonmember banks larger than that would be similarly exposed.

If New York State Housing Finance Agency obligations were added to their holdings of New York City obligations, about 3.5 percent of the nonmember banks in both size categories appeared to be similarly exposed.

The FDIC moved to the second stage of its factfinding in late August when it appeared that the marketing difficulties of the Municipal Assistance Corp. made a New York City default sometime in September or October a more immediate prospect than it had been up to that point in time.

On August 25, I asked each of the Nation's 8,889 nonmember banks—including the 330 FDIC-insured mutual savings banks—to report to the FDIC within 10 days of receipt its holdings of New York City bonds and notes as of any convenient date in August 1975.

This survey, although limited to New York City obligations, had the two advantages of reflecting current information as well as the holdings of all nonmember banks.

The form of this survey, together with my transmittal letters, are attached as exhibits A and B to this statement.

New York City notes were to be reported separately from bonds and the maturity schedules for both were to be reflected.

Such detail was requested only of nonmember banks with more than 20 percent of their total net worth exposed; that is, about 1.5 percent of total assets for the typical nonmember bank—the 20-percent figure reflecting an interagency judgment that most banks below that cut-off would probably not experience significant adverse consequences if New York City were to default.

By early October, the reports of 8,606 nonmember banks had been received—about a 97-percent response.

Of the 8,606 reporting banks, 271 indicated holdings of New York City obligations as of August 1975 amounting to 20 percent or more of their total net worth.

Their holdings of such obligations approximated only \$265 million of New York City's total outstanding debt and was distributed as shown on the table on page 5 of my statement.

The 271 nonmember banks reflected on that table were located in 34 States, with 10 or more located in Alabama, Arkansas, Florida, Illinois, Louisiana, Missouri, New York, Tennessee, and Texas.

The 56 nonmember banks reporting the largest concentrations of New York City obligations, that is, 50 percent or more of their worth, were located in 18 States, with only 5 States having 4 or more such nonmembers: Arkansas, Florida, Illinois, Missouri, and New York.

The size distribution of these 271 banks was as listed on the table on page 6 of my statement, with all but 5 of them below \$100 million in total deposits as of June 30, 1975.

The largest bank reflected on that list was a mutual savings bank headquartered in New York City which had total holdings of New York City obligations equal to less than 30 percent of its net worth.

The two banks in the \$100 million to \$500 million category having 50 percent or more of their net worth exposed were actually in the \$200 million to \$300 million size range and both were headquartered in New York State.

With respect to the 56 nonmember banks which reported August holdings of New York City obligations equal to 50 percent or more of their net worth, a bank-by-bank review by the FDIC's Division of Bank Supervision revealed that the seriousness of their exposure was considerably less than the numbers alone might suggest.

A good number were exceptionally well capitalized so, that even a 50-percent markdown in the value of their New York City holdings in the event of a default would still leave them with a healthy and respectable capital-to-assets ratio.

Others were members of large multibank holding companies or had access to obvious sources of additional capital, so that any significant writedown of their New York City obligations because of a New York City default would not necessarily lead to supervisory concern.

Many of the 56 were thought to be so conservatively managed, with such a low level of classified assets, that a significant writedown of capital because of a New York City default would similarly not lead to supervisory concern.

A few held New York City obligations maturing in the last few months of 1975 so that any successful refinancing by New York City or the Municipal Assistance Corp. would remove them from the list altogether.

Only one of the 56 banks was on the FDIC's current problem bank list.

Taking all of these ameliorating factors into account, the FDIC reached the conclusion that if default were limited to New York City obligations and if the capital losses involved were limited to 50 percent of each bank's book value for such obligations, less than half of these 56 nonmember banks would be cause for supervisory concern, and as to those the consequences would not be immediate since the bank agencies were prepared to postpone any requirement for a writedown of these obligations for several months while market conditions stabilized and the political authorities involved had an opportunity to remedy the default.

While this conclusion was reassuring, given the assumptions made, as to the impact of a New York City default on the Nation's 8,889 nonmember banks, our factual analysis had not yet taken fully into account the potential impact of a greater writedown in value than 50 percent or the additional complications of possible default by issuers of State and local obligations other than New York City.

To develop the information FDIC examiners during the past 2 weeks have obtained from those nonmember banks information as to their holdings of State and local obligations other than New York

City bonds and notes, including maturity distributions and issue-by-issue information for issuers like the New York State Housing Finance Agency which finance many different categories of construction through separate financing programs.

The nonmember banks covered in this third-stage of the FDIC fact-finding effort consisted of the 271 banks which I referred to earlier whose holdings of New York City obligations in August exceeded 20 percent or more of their net worth, all 245 nonmember banks with total assets in excess of \$100 million as of June 30, 1975, the 200 nonmember banks which reported the largest percentage of asset holdings in State and local obligations as of June 30, 1975, and all nonmember banks on the current FDIC problem bank list.

This further review revealed that approximately 305 nonmember banks hold New York State, New York State agency and New York City obligations amounting in the aggregate to 20 percent or more of their net worth.

The par value of such holdings totaled slightly over \$560 million of the outstanding debt of all three types of issues, and were distributed in accordance with the table on page 9 of my statement.

The 305 nonmember banks reflected in that table are located in 40 States, with 10 or more located in Alabama, Arkansas, Florida, Illinois, Louisiana, Mississippi, Missouri, New York, Tennessee, and Texas.

The FDIC's Division of Bank Supervision has conducted a review of the financial circumstances in which each one of these 305 banks might find themselves under the most adverse market circumstances we believe should be hypothesized at this point in time, namely:

(i) That a default by New York City would be followed by a default on the part of all New York State agency issuers and by New York State itself; and

(ii) That the book value of all outstanding obligations of each of these issuers would be eroded in the market not merely by 50 percent, but by 75 percent.

Applying these extreme assumptions, it is our considered view that 64 of these 305 nonmember banks would be in need of additional capital, but that approximately 35 of the 64 are likely to have available to them sources of private capital.

This means that approximately 30 nonmember banks would be the subject of intensive supervisory concern—8 of them are already on the current FDIC problem bank list for other reasons—and might be in need of temporary capital assistance from the FDIC in accordance with our interagency contingency planning.

To summarize the results of our findings to date on the potential impact of a New York City default on the Nation's 8,889 nonmember banks, the FDIC believes that significantly less than 30 nonmember banks would present serious cause for supervisory concern if only New York City defaulted and if the loss in the market value of its outstanding obligations did not exceed 50 percent of their face amount but that the number of such nonmember banks which would be in serious trouble if the default extended to New York State and New York State agency obligations and if the market eroded 75 percent of the par value of their outstanding issues would probably not exceed 30.

Obviously the potential impact on nonmember banks could become significantly more serious if other municipalities besides New York City were forced to default because of general turbulence in the markets for State and local obligations.

However, I am encouraged by the October 10 Congressional Budget Office staff study on New York City's fiscal problem to believe that any such default would most likely be temporary and might not, therefore, involve the banks of this country in any mandatory writedown of obligations issued by such municipalities.

I would be glad to answer questions at the end of the testimony.  
[Statement and exhibits A and B follow:]



FOR RELEASE UPON DELIVERY

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Statement on

THE POTENTIAL IMPACT OF A NYC  
DEFAULT ON NONMEMBER BANKS

Submitted to the

Committee on Banking, Housing and Urban Affairs  
United States Senate

by

Frank Wille, Chairman  
Federal Deposit Insurance Corporation

October 18, 1975

The Federal Deposit Insurance Corporation is pleased to contribute certain factual information about the potential impact on the banking system of a New York City default to the Committee's deliberations on various bills to provide financial assistance to municipalities and/or States and their agencies in distress.

At the outset, I should note that the FDIC surveys have been limited to the nation's 8,889 nonmember banks which the FDIC examines on a regular basis, i.e. those insured banks, including mutual savings banks, which do not belong to the Federal Reserve System. An accurate overall view of the the banking system's exposure must, therefore, include an aggregation of the information developed by the Comptroller of the Currency and the Federal Reserve System for member banks in addition to the FDIC's results for nonmember banks.

Secondly, the FDIC has sought to obtain factual information as to the holdings of various types of State and local obligations by nonmember banks and then to apply a variety of market assumptions to that information in order to quantify the full range of possible impact on nonmember banks which might be caused by a New York City default. The FDIC has no background of expertise, however, with which to evaluate likely market reactions in the event of a New York City default, and must therefore caution the Committee that its estimates of impact on nonmember banks are only as good as the assumptions on which they are based.

Any prediction as to impact requires two basic assumptions to be made. One relates to the extent market values of State and local government obligations, particularly those issued by New York City, will drop if a default occurs, and the other relates to whether or not issuers of State and local obligations other than New York City will also be forced to default because

market developments make it impossible for them to roll over existing debt in a timely manner. The various market assumptions FDIC has made in preparing its estimates are clearly expressed later in this Statement and are obviously fundamental to the FDIC's predictions.

Thirdly, the FDIC has viewed the potential effects on the banking system to be serious enough to warrant contingency planning on a joint basis with the other bank regulatory agencies in three areas which relate to the safety and solvency of individual institutions: (i) the examination treatment of defaulted obligations held by an insured bank, (ii) the liquidity needs of particular banks whose holdings of affected State and local obligations may result in adverse depositor reaction, and (iii) the capital needs of particular banks which suffer a loss of public confidence because of such holdings. I am sure that all of us who are here today from the three Federal bank agencies would be glad to respond to any questions members of the Committee may have concerning these contingency plans.

The FDIC surveys of nonmember bank holdings of selected State and local obligations have been conducted in three stages. The first effort, which began in late July, was a review of the most recent FDIC examination workpapers for a selected sample of approximately 540 nonmember commercial banks, including all of the 44 nonmember commercial banks located in New York State, in order to estimate the relative percentages which each bank's holdings of New York City and New York State Housing Finance Agency obligations bore to that bank's total capital and reserves. The sample of nonmember banks used in this initial survey (other than those in New York State) consisted of those nonmember banks which had been supplying weekly money supply data during a recent ten-month period ending in May, the

purpose of which was to assist the Federal Reserve System to estimate more accurately the nonmember component of the nation's money supply. For that purpose, the sample had been reasonably representative of all nonmember banks in the country, but we recognized that its use for estimating nonmember holdings of the two types of issues in question might not produce estimates with the same degree of reliability. In addition, the data derived would reflect different dates of examination, some of them more than six months before. Nonetheless, this type of survey was manageable in numbers and could be made without undue publicity at a delicate time for New York City and the Municipal Assistance Corporation in their refinancing efforts. This survey, which we recognized would result in a rough approximation only, of the holdings of the nation's 8,559 nonmember commercial banks, showed the following:

- In New York State, there were only 8 nonmember banks, smaller than \$100 million in total deposits, which held New York City obligations representing 25% or more of total capital and reserves, and only one nonmember over \$100 million in deposit size with a comparable exposure.
- In New York State, if holdings of New York State Housing Finance Agency obligations were added to those of New York City, there were only 12 nonmember banks, smaller than \$100 million total deposits, which had 25% or more of their total capital and reserves exposed, and only 4 nonmember banks over \$100 million in deposit size similarly exposed.
- In New York State, less than one-third of the nonmember banks appeared to have capital exposures between 10% and 25%, based

on their holdings of similar obligations.

-- Nationwide, it appeared that approximately two and a half percent of all nonmember banks below \$100 million in deposit size would have holdings of New York City obligations in excess of 25% or more of their total capital and reserves, while only about 1% of the nonmember banks larger than that would be similarly exposed. If New York State Housing Finance Agency obligations were added to their holdings of New York City obligations, about three and one-half percent of the nonmember banks in both size categories appeared to be similarly exposed.

The FDIC moved to the second stage of its fact-finding in late August when it appeared that the marketing difficulties of the Municipal Assistance Corporation made a New York City default sometime in September or October a more immediate prospect than it had been up to that point in time. On August 25, I asked each of the nation's 8,889 nonmember banks -- including the 330 FDIC-insured mutual savings banks -- to report to the FDIC within ten days of receipt its holdings of New York City bonds and notes as of any convenient date in August 1975. This survey, although limited to New York City obligations, had the two advantages of reflecting current information as well as the holdings of all nonmember banks. The form of this survey, together with my transmittal letters, are attached as Exhibits A and B to this statement. New York City notes were to be reported separately from bonds and the maturity schedules for both were to be reflected. Such detail was requested only of nonmember banks with more than 20% of their total net worth exposed (i.e. about 1.5% of total assets for the typical nonmember bank) --- the 20% figure reflecting an interagency judgment that most banks below that cutoff would probably not experience significant

adverse consequences if New York City were to default.

By early October, the reports of 8,606 nonmember banks had been received -- about a 97% response. Of the 8,606 reporting banks, 271 indicated holdings of New York City obligations as of August 1975 amounting to 20% or more of their total net worth. Their holdings of such obligations approximated only \$265 million of New York City's total outstanding debt, and was distributed as follows:

New York City Obligations  
(dollar amounts in thousands)

	<u>Number of Banks</u>	<u>Notes</u>	<u>Bonds</u>	<u>Total</u>
Current book value as % of Net Worth:				
20% to 30%	125	\$24,550	\$53,325	\$77,875
30% to 40%	54	3,120	22,223	25,343
40% to 50%	36	5,837	18,357	24,094
50% to 70%	36	19,007	16,589	35,596
Over 70%	<u>20</u>	<u>69,101</u>	<u>32,629</u>	<u>101,730</u>
	271	\$121,615	\$143,123	\$264,638

The 271 nonmember banks reflected in the above table were located in 34 States, with ten or more located in Alabama, Arkansas, Florida, Illinois, Louisiana, Missouri, New York, Tennessee and Texas. The 56 nonmember banks reporting the largest concentrations of New York City obligations, i.e. 50% or more of their net worth, were located in 18 States, with only 5 States having 4 or more such nonmembers (Arkansas, Florida, Illinois, Missouri and New York).

The size distribution of these 271 banks was as follows, with all but 5 of them below \$100 million in total deposits (as of June 30, 1975):

Holdings of New York City Obligations, by Size of BankInsured Banks Having NYC Obligations  
as Percent of Capital and Reserves of:

<u>Deposit Size (millions)</u>	<u>20-50%</u>	<u>50-70%</u>	<u>Over 70%</u>	<u>Totals</u>
Less than \$1.	-	-	-	-
1 - 2	2	-	-	2
2 - 5	27	5	4	36
5 - 10	66	18	2	86
10 - 25	76	7	8	91
25 - 50	29	3	2	34
50 - 100	12	2	3	17
100 - 500	2	1	1	4
\$500 - \$1,000	1	-	-	1
Over \$1 billion	-	-	-	0
Totals	<u>215</u>	<u>36</u>	<u>20</u>	<u>271</u>

The largest bank reflected on the above list was a mutual savings bank headquartered in New York City which had total holdings of New York City obligations equal to less than 30% of its net worth. The two banks in the \$100-\$500 million category having 50% or more of their net worth exposed were actually in the \$200 - \$300 million size range and both were headquartered in New York State.

With respect to the 56 nonmember banks which reported August holdings of NYC obligations equal to 50% or more of their net worth, a bank-by-bank review by the FDIC's Division of Bank Supervision revealed that the seriousness of their exposure was considerably less than the numbers alone might suggest. A good number were exceptionally well capitalized,

so that even a 50% mark-down in the value of their NYC holdings in the event of a default would still leave them with a healthy and respectable capital to assets ratio. Others were members of large multibank holding companies or had access to obvious sources of additional capital, so that any significant write-down of their New York City obligations because of a New York City default would not necessarily lead to supervisory concern. Many of the 56 were thought to be so conservatively managed, with such a low level of classified assets, that a significant write-down of capital because of a New York City default would similarly not lead to supervisory concern. A few held NYC obligations maturing in the last few months of 1975 so that any successful refinancing by New York City or the Municipal Assistance Corporation would remove them from the list altogether. Only one of the 56 banks was on the FDIC's current problem bank list.

Taking all of these ameliorating factors into account, the FDIC reached the conclusion that if default were limited to New York City obligations and if the capital losses involved were limited to 50% of each bank's book value for such obligations, less than half of these 56 nonmember banks would be cause for supervisory concern, and as to those the consequences would not be immediate since the bank agencies were prepared to postpone any requirement for a write-down of these obligations for several months while market conditions stabilized and the political authorities involved had an opportunity to remedy the default.

While this conclusion was reassuring, given the assumptions made, as to the impact of a New York City default on the nation's 8,889 nonmember banks, our factual analysis had not yet taken fully into account

the potential impact of a greater write-down in value than 50% or the additional complications of possible default by issuers of State and local obligations other than New York City. To develop this information, FDIC examiners during the past two weeks have obtained from those nonmember banks we thought most likely to be exposed to adverse market developments detailed information as to their holdings of State and local obligations other than New York City bonds and notes, including maturity distributions and issue by issue information for agency issuers like the New York State Housing Finance Agency which finance many different categories of construction through separate financing programs. The nonmember banks covered in this third stage of the FDIC fact-finding effort consisted of the 271 banks whose holdings of New York City obligations in August exceeded 20% or more of their net worth, all 245 nonmember banks with total assets in excess of \$100 million as of June 30, 1975, the 200 nonmember banks which reported the largest percentage of asset holdings in State and local obligations as of June 30, 1975, and all nonmember banks on the current FDIC "problem bank" list.

This further review revealed that approximately 305 nonmember banks hold New York State, New York State agency and New York City obligations amounting in the aggregate to 20% or more of their net worth. The par value of such holdings totalled slightly over \$560 million of the outstanding debt of all three types of issues,\*/ and were distributed among these banks as follows:

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\*/ These figures include the 271 banks, referred to on Page 5 of this Statement, which held New York City obligations in August of \$265 million, after minor adjustments for survey errors and retirements of New York City obligations during September were made.

New York State, New York State agency and New York City Obligations  
(dollar amounts in thousands)

<u>Current book Value as % of Net Worth</u>	<u>Number of Banks</u>	<u>NYS</u>			<u>Total</u>
		<u>NYS</u>	<u>Agency</u>	<u>City</u>	
20% to 30%	97	\$11,808	\$ 38,630	\$ 44,127	\$ 94,565
30% to 40%	79	29,780	74,160	67,729	171,669
40% to 50%	41	6,571	22,478	25,730	54,779
50% to 70%	43	4,660	14,215	30,924	49,799
Over 70%	<u>45</u>	<u>31,925</u>	<u>63,938</u>	<u>93,798</u>	<u>189,661</u>
Total	305	\$84,744	\$213,421	\$262,308	\$560,473

The 305 nonmember banks reflected in the above table are located in 40 States, with 10 or more located in Alabama, Arkansas, Florida, Illinois, Louisiana, Mississippi, Missouri, New York, Tennessee and Texas.

The FDIC's Division of Bank Supervision has conducted a review of the financial circumstances in which each one of these 305 banks might find themselves under the most adverse market circumstances we believe should be hypothesized at this point in time: namely, (i) that a default by New York City would be followed by a default on the part of all New York State agency issuers and by New York State itself, and (ii) that the book value of all outstanding obligations of each of these issuers would be eroded in the market not merely by 50%, but by 75%. Applying these extreme assumptions, it is our considered view that 64 of these 305 nonmember banks would be in need of additional capital, but that approximately 35 of the 64 are likely to have available to them sources of private capital. This means that approximately 30 nonmember banks would be the subject of intensive supervisory concern

(8 of them are already on the current FDIC problem bank list for other reasons) and might be in need of temporary capital assistance from the FDIC in accordance with our interagency contingency planning.

To summarize the results of our findings to date on the potential impact of a New York City default on the nation's 8,889 nonmember banks, the FDIC believes that significantly less than 30 nonmember banks would present serious cause for supervisory concern if only New York City defaulted and if the loss in the market value of its outstanding obligations did not exceed 50% of their face amount, but that the number of such nonmember banks which would be in serious trouble (i) if the default extended to New York State and New York State agency obligations and (ii) if the market eroded 75% of the par value of their outstanding issues would probably not exceed 30.

Obviously, the potential impact on nonmember banks could become significantly more serious if other municipalities besides New York City were forced to default because of general turbulence in the markets for State and local obligations. However, I am encouraged by the October 10 Congressional Budget Office staff study on New York City's Fiscal Problem to believe that any such default would most likely be temporary and might not, therefore, involve the banks of this country in any mandatory write-down of obligations issued by such municipalities.



OFFICE OF THE CHAIRMAN

EXHIBIT A

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D. C. 20429

BL-20(c)  
August 25, 1975

TO THE CHIEF EXECUTIVE OFFICER OF THE BANK ADDRESSED:

Subject: Holdings of New York City Obligations

The FDIC would appreciate your assistance in developing accurate and current information of the extent of nonmember bank holdings of bonds and notes of the City of New York, so that in conjunction with information supplied by the Comptroller of the Currency and the Federal Reserve System for member banks the exposure of all insured banks in the event of a default by New York City may be known. This information is being developed as a precautionary measure, and should not be construed as any indication that the Federal bank agencies are either expecting or predicting such a default. The survey, moreover, is being undertaken to confirm our preliminary estimate, based largely on a sampling of 1974 reports of examination, that only a limited number of nonmember banks has any significant amount of New York City obligations.

Please complete and return the form on the reverse side of this memorandum within ten days of receipt, furnishing information as to your bank's holdings of such obligations as of any convenient date in August 1975. A simple checkmark in the space provided will suffice if your bank's aggregate holdings of New York City obligations are less than 20% of the bank's total capital and reserves. If your bank's holdings are 20% or more of total capital and reserves, please fill in the more detailed information requested.

Frank Wille  
Chairman

FEDERAL DEPOSIT INSURANCE CORPORATION  
 SPECIAL SURVEY OF NEW YORK CITY OBLIGATIONS

**INSTRUCTIONS:** Complete all applicable items below and return within 10 days to Director of Research, Room 3008 G, Federal Deposit Insurance Corporation, Washington, D.C. 20429. Report obligations of New York City only. Do not include obligations of New York State or any of its agencies or obligations of the Municipal Assistance Corporation.

**ITEM 1.** If current book value holdings of New York City issues are less than 20 percent of the bank's total capital and reserves as of June 30, 1975, check the block at right and return the form in the enclosed envelope.

**ITEM 2.** If current book value holdings of New York City issues are 20 percent or more of the bank's total capital and reserves as of June 30, 1975, complete **A** and **B** below.

**A. BOOK VALUE OF HOLDINGS BY MATURITY**

DESCRIPTION	Maturity Period						TOTAL
	1975	Jan.-June 1976	July-Dec. 1976	1977-1979	1980-1985	1986-1995	
Notes							
Bonds							
TOTAL							

<b>B. Total Capital and Reserves as of June 30, 1975</b> \$	NAME AND BUSINESS PHONE NUMBER OF PERSON FILLING IN REPORT
--	--

EXHIBIT B

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D. C. 20429

OFFICE OF THE CHAIRMAN

BL-20(m)  
August 25, 1975

TO THE CHIEF EXECUTIVE OFFICER OF THE MUTUAL SAVINGS BANK ADDRESSED:

Subject: Holdings of New York City Obligations

The FDIC would appreciate your assistance in developing accurate and current information of the extent of nonmember bank holdings of bonds and notes of the City of New York, so that in conjunction with information supplied by the Comptroller of the Currency and the Federal Reserve System for member banks the exposure of all insured banks in the event of a default by New York City may be known. This information is being developed as a precautionary measure, and should not be construed as any indication that the Federal bank agencies are either expecting or predicting such a default. The survey, moreover, is being undertaken to confirm our preliminary estimate, based largely on a sampling of 1974 reports of examination, that only a limited number of nonmember banks has any significant amount of New York City obligations.

Please complete and return the form on the reverse side of this memorandum within ten days of receipt, furnishing information as to your bank's holdings of such obligations as of any convenient date in August 1975. A simple checkmark in the space provided will suffice if your bank's aggregate holdings of New York City obligations are less than 20% of the bank's total surplus and reserves. If your bank's holdings are 20% or more of total surplus and reserves, please fill in the more detailed information requested.

Frank Wille  
Chairman

FEDERAL DEPOSIT INSURANCE CORPORATION  
 SPECIAL SURVEY OF NEW YORK CITY OBLIGATIONS

**INSTRUCTIONS:** Complete all applicable items below and return within 30 days to Director of Research, Room 3008 G, Federal Deposit Insurance Corporation, Washington, D.C. 20429. Report obligations of New York City only. Do not include obligations of New York State or any of its agencies or obligations of the Municipal Assistance Corporation.

**ITEM 1.** If current book value holdings of New York City issues are less than 20 percent of the bank's total surplus accounts as of June 30, 1975, check the block at right and return the form in the enclosed envelope.

**ITEM 2.** If current book value holdings of New York City issues are 20 percent or more of the bank's total surplus accounts as of June 30, 1975, complete **A** and **B** below.

**A. BOOK VALUE OF HOLDINGS BY MATURITY**

Express figures in thousands of dollars as of any convenient day in August. Enter date in block at right.

DESCRIPTION	MATURITY PERIOD							TOTAL
	1975	Jan.-June 1976	July-Dec. 1976	1977-1979	1980-1985	1986-1995	After 1995	
Notes								
Bonds								
TOTAL								

DATE (As of August), 1975

**B. Total Surplus Accounts as of June 30, 1975**

\$

NAME AND BUSINESS PHONE NUMBER OF PERSON FILLING IN REPORT

The CHAIRMAN. Thank you, Mr. Wille.

Mr. Smith?

MR. SMITH. If I may, let me summarize the tables which are included in my statement.

Our survey, like the FDIC survey, has been conducted in a three-stage development. In the beginning, back in July, we wanted to do as little as we could to contribute to any further negative impulse in terms of market quality. We first assessed the national banks' holdings on a discreet basis from our own work papers taken from the most recent examination. Those reports of examination and work papers revealed at that time, in July, that we could identify some 1,746 national banks, holding about \$1.7 billion in New York City's securities.

Of that group, we identified 153 banks, whose holdings of New York City securities represented in excess of 20 percent of the bank's capital accounts.

With respect to that 153, we then went to the bank to verify current holdings, recognizing our work papers represented examinations which could be from 6 to 10 months old at the time we were working with them. From that group of 153, after verification with the banks, we identified 53 national banks whose holdings either exceeded 40 percent of their capital accounts or were close enough to that line, and they had associated asset problems that caused us to believe they were deserving of our special supervisory attention. Of those 53, they had total assets of \$4 billion, rounded. We endeavored to make a qualitative classification of what would occur in the event of a New York City default. This is an arbitrary assumption—an assumption of substantial long-term impairment in all of the City's obligations. On that basis, we rated those 53 banks in four groups.

Group 1, we concluded, represented banks in which insolvency would be a very distinct possibility. In other words, long-term capital support, liquidity support, simply could not solve their problem at all. In all likelihood, we would have to consider merger possibilities. The nine banks in this group are located in five States and have total assets of \$898 million.

Group 2, 18 banks, are banks which we think with some long-term capital support, perhaps including assistance from FDIC under Section 13(c) of the Federal Deposit Insurance Act, could make it.

Group 3, 22 banks, representing over \$2 billion in assets, were determined by us to be banks which would probably suffer some short-term liquidity problems, but problems that in the main could be met by some liquidity support, and four banks in group 4, we concluded could make it on their own.

We then, as the substantive link between the State and the city hardened with the enactment of the State's emergency legislation, deemed it provident to begin some survey of the holdings of New York State obligations and national banks.

Again, however, not wishing to contribute adversely to market psychology, we limited the extent of that survey. We began with the banks which we knew held more than 20 percent of their capital accounts in New York City's obligations and we added to that the 50 largest national banks in the country. We have identified, and this is at the top of page 7 of my statement, in those 203 banks, holdings of

New York City—New York State obligations in the amount of \$1.3 billion. We have set forth at the bottom of page 7 those banks out of the 203 which, if you combine New York City and New York State obligations, would have holdings equal to or in excess of 40 percent of their capital accounts.

As you see that figure is 93 national banks, with total assets of slightly over \$8 billion. We have endeavored on page 8, and with respect to this combined holding, to list the geographic distribution of those banks. They are located in some 20 States, with the predominant number of those banks being located in the State of New York and the State of Florida.

The last step that we have taken, Mr. Chairman, and have just taken this past weekend, is a universal survey of all 4,700 national banks in which we have asked them to provide us as of September 30, the closing of the third quarter, their total New York State and New York City holdings, not only in their trading and investment accounts, but in their trust departments and in collateral accounts, if they are holding any in a collateral form.

We, in conducting this survey, make no judgments about New York State's obligations. We most specially make no judgments about the fiduciary powers exercised by banks with respect to trust department holdings. What we are endeavoring to do here is to conduct a census of New York City and New York State holdings. In the event there were a need for debt restructuring, we think we could provide some assistance in terms of identifying where the major holdings are situated.

In conclusion, on much the same basis as Chairman Willie has commented, if we could determine that in the wake of the New York City default that the severe value impairment beyond the short run would be limited to New York City obligations, we then regard that event from the standpoint of the national banking system as a controllable event, although admittedly an unpleasant one. Thank you.

[Complete statement of Mr. Smith follows:]

Statement of James E. Smith  
Comptroller of the Currency  
before the  
Senate Committee on Banking, Housing and Urban Affairs  
Saturday, October 18, 1975

I appreciate the opportunity to appear before you today to present a summary of the survey and analysis which my office has conducted with respect to the impact which a default of New York City could have on the national banking system.

Our Office has conducted during late summer and early fall of this year a multi-faceted survey of national banks which hold obligations of New York City and New York State.

On July 24, 1975, I directed each of the 14 Regional Administrators to obtain from their examiners the name of each national bank investing in New York City obligations and the total par value amount of these obligations held by the bank. The examiners compiled this information through an internal review of their working papers relating to the most recent examination of each bank. The review was discreet, as national banks were not alerted to the compilation.

We determined from the review that 1,746 national banks held New York City obligations with par value of \$1,753,525,000. We identified within this list 153 banks which were holding New York City obligations which exceeded 20% of their gross capital funds. These tabulations were verified during the week of August 18, 1975, with these banks by telephone.

By September 5, 1975, we had analyzed each national bank which held New York City obligations in an amount exceeding 40% of gross capital funds. In addition, selected banks under the cut-off percentage were also analyzed. Altogether fifty-three banks were reviewed by both regional and Washington personnel.

We attempted to appraise each bank's financial capacity to absorb the potential loss and to isolate those banks which could face insolvency or liquidity problems and which would require outside assistance from private sources or from the Federal Reserve and/or the FDIC. The banks analyzed were rated in four groups.

Group I banks are the most critical because insolvency is a distinct possibility in the event of a New York City default. In these banks, capital would be substantially impaired. Liquidity support from the Federal Reserve would undoubtedly be sought, and FDIC assistance also might be needed in the form of a loan or an assisted sale.

Group II banks appear financially capable of absorbing initially the write-down of New York City obligations, but most would be left seriously undercapitalized and would have to pursue recapitalization, sale, or merger possibilities. Many of these banks have serious asset problems, poor sales prospects, negligible support from owners, directors, or officers, and doubtful support from parent holding companies. During the period immediately following default, short-term liquidity assistance from the Federal Reserve may be a necessity. Most of these banks appear to have good prospects for survival, but some may require extended assistance depending on local reaction and a myriad of other factors.

Group III banks should be able to absorb the initial write-down. Some may require additional capital, but others may be able to survive without outside assistance. In addition, most of these banks appear to have minimal asset problems combined with good prospects for sales and support from wealthy owners, directors, and parent holding companies. Losses to these banks, however, still will be significant, and some liquidity assistance from the Federal Reserve may be necessary.

Group IV banks appear to be able to absorb the losses in their own right or with some help from financially capable and responsible parents or other ownership groups.

Our initial review indicated that a New York City default could have the following impact on the national banks analyzed:

TABLE ONE  
FIFTY-THREE BANKS

<u>Group Rating</u>	<u>Banks</u>	<u>Assest of Banks Within Group (Millions)</u>
I	9	\$ 898
II	18	737
III	22	2,251
IV	4	145
	<u>53</u>	<u>\$ 4,031</u>

A further breakdown shows distribution measured by holdings of New York City obligations against gross capital funds:

TABLE TWO  
FIFTY-THREE BANKS  
DISTRIBUTION MEASURED BY HOLDINGS OF NEW YORK  
CITY OBLIGATIONS AGAINST GROSS CAPITAL FUNDS

<u>New York City Obligations/Gross Capital</u>	<u>No. of Banks</u>	<u>Assets of Banks Within Category (Millions)</u>
Under 40%	5	\$ 596
40% to 50%	8	1,232
50% to 100%	29	1,777
100% to 150%	9	383
150% to 200%	0	0
Over 200%	2	43
	<u>53</u>	<u>\$ 4,031</u>

It is also helpful to note the geographical distribution of these holdings based on the September analysis:

GEOGRAPHICAL DISTRIBUTION OF THE FIFTY-THREE BANKS

<u>REGION</u>	<u>NO. OF BANKS</u>	<u>ASSETS OF BANKS WITHIN GROUP (Millions)</u>
1	3	214
2	14 (All in N.Y.State)	2,028
3	1	62
4	1	26
5	4	121
6	15 (All in Florida)	687
7	4	113
8	1	39
9	3	120
10	3	361
11	1	10
12	1	33
13	0	-0-
14	2	217
	53	4,031

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Region 1 - Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont  
 Region 2 - New Jersey, New York  
 Region 3 - Delaware, Pennsylvania  
 Region 4 - Indiana, Kentucky, Ohio  
 Region 5 - District of Columbia, Maryland, North Carolina, Virginia, West Virginia  
 Region 6 - Florida, Georgia, South Carolina  
 Region 7 - Illinois, Michigan  
 Region 8 - Alabama, Arkansas, Louisiana, Mississippi, Tennessee  
 Region 9 - Minnesota, North Dakota, South Dakota, Wisconsin  
 Region 10 - Iowa, Kansas, Missouri, Nebraska  
 Region 11 - Oklahoma, Texas  
 Region 12 - Arizona, Colorado, New Mexico, Utah, Wyoming  
 Region 13 - Alaska, Idaho, Montana, Oregon, Washington  
 Region 14 - California, Hawaii, Nevada

Our appraisal of the impact upon each bank was done on a pre-tax basis. Any of these banks which has taxable income over an eight-year period, beginning three years before any losses are realized, will be able to mitigate substantially the effect upon the bank of such losses through a reduction of federal income taxes. Such mitigation of possible losses has not been taken into account in our analysis.

On September 9, 1975, I directed national bank examiners to visit each of the 27 banks in Groups I and II to verify holdings of New York City obligations, to analyze each bank's exposure and financial capacity to absorb the substantial losses which would be evident in the case of default, to prepare a liquidity analysis, and to appraise the bank's ability to raise additional capital from inside and outside sources. These special examinations were completed by September 16, 1975, and reviewed in Washington. However, the only material change made in the Group Ratings assigned above was the removal from Group II to Group IV of one small bank with assets of \$33 million, because most of its New York City holdings had matured in August and had been redeemed.

On October 3, 1975, a limited survey was conducted to ascertain the amount of New York State obligations and New York State Housing issues held within the national banking system. This survey, conducted by telephone through the fourteen regional offices, focused on the largest fifty national banks plus all other banks whose holdings of New York City obligations exceeded 20% of their gross capital funds.

Following is a summary of the results of this survey. All figures represent book value.

New York State Obligations	(Thousands)	
Bonds	\$ 577,558	
Notes	185,712	\$763,270
New York State Housing (11 issues)		
Urban Rental Housing	86,064	
Non-Profit Housing	73,314	
Hospitals & Nursing Homes	52,322	
Medical Care Facilities		
Finance Agency	19,616	
All Other	359,058	\$590,374
		<u>\$1,353,644</u>

As additional information, the following table shows the number of national banks in each category when the combined holdings of New York City and State obligations are taken as a percentage of gross capital funds:

NINETY-THREE BANKS  
DISTRIBUTION MEASURED BY HOLDINGS OF  
NEW YORK CITY AND STATE OBLIGATIONS AGAINST  
GROSS CAPITAL FUNDS

<u>New York City &amp; State Obligations/Gross Funds</u>	<u>No. of Banks</u>	<u>Assets of Banks Within Category (Millions)</u>
40% to 50%	21	\$ 861
50% to 100%	50	6,086
100% to 150%	17	1,083
150% to 200%	3	86
Over 200%	2	43
	<u>93</u>	<u>\$ 8,159</u>

The geographical distribution of holdings by national banks of both city and state obligations is shown in the following table:

BANKS HOLDING NEW YORK CITY AND STATE OBLIGATIONS  
IN EXCESS OF 40% OF GROSS CAPITAL FUNDS

GEOGRAPHICAL DISTRIBUTION

REGION	NO. OF BANKS	ASSETS OF BANKS WITHIN GROUP (Millions)
1	3	214
2	23 (All in N.Y. State)	5626
3	3	121
4	1	26
5	8	198
6	26 (All in Florida)	1238
7	7	222
8	6	286
9	4	175
10	6	407
11	2	60
12	1	33
13	1	11
14	2	44
	93	8661

Region 1 - Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont  
 Region 2 - New Jersey, New York  
 Region 3 - Delaware, Pennsylvania  
 Region 4 - Indiana, Kentucky, Ohio  
 Region 5 - District of Columbia, Maryland, North Carolina, Virginia, West Virginia  
 Region 6 - Florida, Georgia, South Carolina  
 Region 7 - Illinois, Michigan  
 Region 8 - Alabama, Arkansas, Louisiana, Mississippi, Tennessee  
 Region 9 - Minnesota, North Dakota, South Dakota, Wisconsin  
 Region 10 - Iowa, Kansas, Missouri, Nebraska  
 Region 11 - Oklahoma, Texas  
 Region 12 - Arizona, Colorado, New Mexico, Utah, Wyoming  
 Region 13 - Alaska, Idaho, Montana, Oregon, Washington  
 Region 14 - California, Hawaii, Nevada

While we have made some initial qualitative judgments about the effect on national banks should New York City default, it is certainly more difficult to assess the effect at this time of potential default on various New York State obligations. Thus, our analysis to date is little more than an identification of those banks in which the combined holdings of New York City and New York State obligations are significant when related to capital. Should default occur in any obligations of the City or the State, it seems reasonable to assume that efforts at debt restructuring might be undertaken. To provide some assistance in the task of holder identification, we are now conducting a universal survey of national banks with respect to holdings of all debt issues of New York City and New York State. This survey includes issues held in trust and collateral accounts, as well as those held in the investment and trading accounts. A copy of the survey questionnaire has been provided to the committee. We are now in the process of compiling results from the data which is coming in daily.

Obviously, no flat assertions can be made as to the impact of a New York City default. However, if the value impairment beyond the short-run is largely restricted to the New York City obligations, I believe that, as to the national banking system, the impact, while troublesome and unpleasant, would, nevertheless, be controllable without serious dislocation to the banking system.



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Comptroller of the Currency  
Administrator of National Banks

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Washington, D. C. 20219

TO THE CHIEF EXECUTIVE OFFICER OF THE BANK ADDRESSED:

SUBJECT: New York State and New York City Obligations

This Office will appreciate your cooperation in the development of accurate and current information on the extent of ownership by National Banks of obligations of New York State and New York City and instrumentalities thereof. The survey is for information purposes only and is not to be considered as reflecting any credit judgment of the investments being surveyed.

Please complete and return the enclosed three (3) forms as promptly as possible, but no later than October 24, 1975. All figures should be submitted as of the close of business, September 30, 1975. If inapplicable, please so indicate on forms and return to this office. Self-addressed, franked envelopes are enclosed for the return of the forms. Each form as completed, should be promptly returned to this office in one of the enclosed envelopes.

James E. Smith  
Comptroller of the Currency  
October 10, 1975

NAME OF BANK: \_\_\_\_\_  
 CITY: \_\_\_\_\_  
 STATE: \_\_\_\_\_  
 CHARTER NUMBER: \_\_\_\_\_

**INSTRUCTIONS:** Fill in all applicable items and return as soon as completed but by no later than October 24, 1975 to Comptroller of the Currency, The Administrator of National Banks, Attention: H. O. Price, Jr., National Bank Examiner/Special Situations, Washington, D. C. 20219. Any questions should be directed to H. O. Price, Jr. at (202) 447-1850.

**CITY OF NEW YORK OBLIGATIONS  
 HELD IN THE INVESTMENT & TRADING ACCOUNT**

*PAR MATURITY SCHEDULE  
 Express figures in thousands of dollars as of 9/30/75*

NAME OF OBLIGATION	A	B	C	D	E	F
	BOOK VALUE 9/30/75	9/30/75 to 12/31/75	1/1/76 to 3/31/76	4/1/76 to 6/30/76	After 6/30/76	TOTAL PAR
1. New York City—General Obligations						
2. New York City Education Construction Fund Revenue						
3. New York City Housing Authority						
4. New York City Housing Development Corporation General Housing						
5. New York City Transit Authority Gross Revenue						
6. All Other						
7. Grand Total						

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Person Filling Report

Typed Name: \_\_\_\_\_

Signature: \_\_\_\_\_

Business Phone Number: \_\_\_\_\_

(over)

CC 9060.01 -- 01

NAME OF BANK: \_\_\_\_\_  
 CITY: \_\_\_\_\_  
 STATE: \_\_\_\_\_  
 CHARTER NUMBER: \_\_\_\_\_

**STATE OF NEW YORK OBLIGATIONS HELD  
 IN INVESTMENT & TRADING ACCOUNT**

**PAR MATURITY SCHEDULE**

*Express figures in thousands of dollars as of 9/30/75*

NAME OF OBLIGATION	A	B	C	D	E	F
	BOOK VALUE 9/30/75	9/30/75 to 12/31/75	1/1/76 to 3/31/76	4/1/76 to 6/30/76	After 6/30/76	TOTAL PAR
1. State of New York -- General Obligations						
2. New York State Dormitory Authority						
<i>New York State Housing Finance Agency: (3.-9.)</i>						
3. Health Facilities						
4. Non-Profit Housing Project						
5. General Housing Loan						
6. State University Construction Bonds						
7. Mental Hygiene Improvement Bonds						
8. Hospital & Nursing Home Project Bonds						
9. Urban Rental Project Bonds						
10. New York State Mortgage Agency General Revenue						
11. New York State Power Authority						
12. New York State Urban Development Corporation						
13. Municipal Assistance Corporation for the City of New York						
14. All Other						
15. Grand Total						

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NAME OF BANK: \_\_\_\_\_  
 CITY: \_\_\_\_\_  
 STATE: \_\_\_\_\_  
 CHARTER NUMBER: \_\_\_\_\_

**INSTRUCTIONS:** Fill in all applicable items and return as soon as completed but by no later than October 24, 1975 to Comptroller of the Currency, The Administrator of National Banks, Attention: H. O. Price, Jr., National Bank Examiner/Special Situations, Washington, D. C. 20219. Any questions should be directed to H. O. Price, Jr. at (202) 447-1850.

**OBLIGATIONS OF THE CITY OF NEW YORK  
 PLEDGED TO SECURE BORROWER'S LOANS**

**PAR MATURITY SCHEDULE**  
*Express figures in thousands of dollars as of 9/30/75*

NAME OF OBLIGATION	A BOOK VALUE 9/30/75	PAR MATURITY SCHEDULE				F TOTAL PAR
		B 9/30/75 to 12/31/75	C 1/1/76 to 3/31/76	D 4/1/76 to 6/30/76	E After 6/30/76	
1. New York City—General Obligations						
2. New York City Education Construction Fund Revenue						
3. New York City Housing Authority						
4. New York City Housing Development Corporation General Housing						
5. New York City Transit Authority Gross Revenue						
6. All Other						
7. Grand Total						
8. Number of Loans Secured by City of New York Obligations						

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Person Filling Report

Typed Name: \_\_\_\_\_

Signature: \_\_\_\_\_

Business Phone Number: \_\_\_\_\_

(over)

CC 9060.01 - 03

NAME OF BANK: \_\_\_\_\_  
 CITY: \_\_\_\_\_  
 STATE: \_\_\_\_\_  
 CHARTER NUMBER: \_\_\_\_\_

**OBLIGATIONS OF THE STATE OF NEW YORK  
 PLEDGED TO SECURE BORROWER'S LOANS**

*PAR MATURITY SCHEDULE  
 Express figures in thousands of dollars as of 9/30/75*

NAME OF OBLIGATION	A	B	C	D	E	F
	BOOK VALUE 9/30/75	9/30/75 to 12/31/75	1/1/76 to 3/31/76	4/1/76 to 6/30/76	After 6/30/76	TOTAL PAR
1. State of New York – General Obligations						
2. New York State Dormitory Authority						
<i>New York State Housing Finance Agency: (3 - 8.)</i>						
3. Health Facilities						
4. Non-Profit Housing Project						
5. General Housing Loan						
6. State University Construction Bonds						
7. Mental Hygiene Improvement Bonds						
8. Hospital & Nursing Home Project Bonds						
9. Urban Rental Project Bonds						
10. New York State Mortgage Agency General Revenue						
11. New York State Power Authority						
12. New York State Urban Development Corporation						
13. Municipal Assistance Corporation for the City of New York						
14. All Other						
15. Grand Total						
16. Number of Loans Secured by State of New York Obligations						

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NAME OF BANK: \_\_\_\_\_  
 CITY: \_\_\_\_\_  
 STATE: \_\_\_\_\_  
 CHARTER NUMBER: \_\_\_\_\_

**INSTRUCTIONS:** Fill in all applicable items and return as soon as completed but by no later than October 24, 1975 to Comptroller of the Currency, The Administrator of National Banks, Attention: H. O. Price, Jr., National Bank Examiner/Special Situations, Washington, D. C. 20219. Any questions should be directed to H. O. Price, Jr. at (202) 447-1850.

**OBLIGATIONS OF THE CITY OF NEW YORK  
 HELD BY THE TRUST DEPARTMENT**

*PAR MATURITY SCHEDULE  
 Express figures in thousands of dollars as of 9/30/75*

NAME OF OBLIGATION	A	B	C	D	E	F
	BOOK VALUE 9/30/75	9/30/75 to 12/31/75	1/1/76 to 3/31/76	4/1/76 to 6/30/76	After 6/30/76	TOTAL PAR
1. New York City—General Obligations						
2. New York City Education Construction Fund Revenue						
3. New York City Housing Authority						
4. New York City Housing Development Corporation General Housing						
5. New York City Transit Authority Gross Revenue						
6. All Other						
7. Grand Total						
8. Number of Trust Accounts Containing City of New York Obligations						

Person Filling Report:

Typed Name: \_\_\_\_\_

Signature: \_\_\_\_\_

Business Phone Number: \_\_\_\_\_

(over)

NAME OF BANK: \_\_\_\_\_  
 CITY: \_\_\_\_\_  
 STATE: \_\_\_\_\_  
 CHARTER NUMBER: \_\_\_\_\_

**OBLIGATIONS OF THE STATE OF NEW YORK  
 HELD BY THE TRUST DEPARTMENT**

*PAR MATURITY SCHEDULE  
 Express figures in thousands of dollars as of 9/30/75*

NAME OF OBLIGATION	A	B	C	D	E	F
	BOOK VALUE 9/30/75	9/30/75 to 12/31/75	1/1/76 to 3/31/76	4/1/76 to 6/30/76	After 6/30/76	TOTAL PAR
1. State of New York—General Obligations						
2. New York State Dormitory Authority						
<i>New York State Housing Finance Agency: (3.-9.)</i>						
3. Health Facilities						
4. Non-Profit Housing Project						
5. General Housing Loan						
6. State University Construction Bonds						
7. Mental Hygiene Improvement Bonds						
8. Hospital & Nursing Home Project Bonds						
9. Urban Rental Project Bonds						
10. New York State Mortgage Agency General Revenue						
11. New York State Power Authority						
12. New York State Urban Development Corporation						
13. Municipal Assistance Corporation for the City of New York						
14. All Other						
15. Grand Total						
16. Number of Trust Accounts Containing State of New York Obligations						

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The CHAIRMAN. Thank you, Mr. Smith, Mr. Mitchell.

Mr. MITCHELL. I am glad to appear before this committee today to discuss the possible implications for the financial system of the New York City financial crisis.

The threat of a New York City default—and of difficulties in the tax-exempt market more generally—has caused concern in some quarters regarding the financial condition of our banking system. This concern stems from the fact that commercial banks long have been important investors in State and local government obligations, including those of New York State and New York City. I am appending to my statement a table showing the aggregate involvement of banks in the tax-exempt market. As of mid-1975, all commercial banks had total investments of \$102 billion in such obligations, accounting for 47 percent of all outstanding State and local indebtedness. This was nearly 15 percent of all the loans and investments of the banking system.

A key consideration leading banks to acquire these large positions in State and local obligations has been the record of performance of municipals as a high-quality, low-risk investment. There are other reasons banks hold municipals, including their tax-exempt status and their eligibility as collateral that can be pledged against U.S. and State and local government deposits. While such issues do not have the liquidity and marketability features of U.S. Government issues, the soundness of such investments has seldom been questioned. The historical record for ultimate payment of principal and interest, even among governmental units that have defaulted on their obligations, has been remarkably good.

The record is well documented by the experience of the depression years of the 1930's, when close to 4,800 State and local units out of more than 150,000 were reported to have defaulted on their debts, including 48 cities with populations of 25,000 or more. According to a study published by the Advisory Commission on Intergovernmental Relations, the indebtedness of the defaulting units at time of default was \$2.7 billion—close to 18 percent of the total amount of local debt outstanding.<sup>1</sup> Yet, by 1938, all 48 cities were reported out of default, and by 1945 nearly all units of any significant size had settled their default problems. The loss of principal and interest resulting from recorded defaults during the depression period, according to a study by the National Bureau of Economic Research, is estimated to have aggregated only \$100 million or about one-half of 1 percent of the average amount of State and local debt outstanding in the period.<sup>2</sup>

Experience with municipal debt in the postwar years has reaffirmed the record for high quality established during the depression. Although more than 400 State and local default situations had been reported between 1945 and early 1970, most of these appear to have been temporary or technical in nature and to have involved quite small governmental units. The principal amount of debt reported as in default as to principal or interest from 1945 through early 1970 cumulated to approximately \$450 million, or less than one-half of 1 percent of the total municipal debt outstanding in 1970. And the

<sup>1</sup> *City Financial Emergencies: The Intergovernmental Dimension*, 1973.

<sup>2</sup> Hempel, George H., *The Postwar Quality of State and Local Debt*, National Bureau of Economic Research, 1971, p. 24. The lost figures do not include lower interest payments on refunding issues or accrued interest on unpaid principal or interest.

bulk of this total \$334 million—was accounted for by revenue bonds on three major projects—the West Virginia Turnpike, Calumet Skyway Toll Bridge, and Chesapeake Bay Bridge and Tunnel. An additional \$72 million was accounted for by 21 other default situations involving amounts of \$1 million or more, of which only two were general obligation bonds.

This experience leads me to believe that the chances of ultimate significant loss, especially by investors in general obligation bonds, are relatively small. Even if New York City should default for a time on its obligations, the economic tax base will remain and the city will have to cure the default in one way or another before it can reenter the credit market. In view of the high probability of ultimate final repayment—which means that the securities will continue to have market value—the Federal bank supervisory agencies have agreed that a reasonable length of time will be permitted, if there is a default, before banks would be required to write down the book value of their holdings to market value. During this interim period of up to 6 months, the default might well be cured and markets return to normal. But even if this does not happen, it is important to recognize that the amount charged off against a bank's capital account would undoubtedly be far less than the book value of the security holdings involved.

We nevertheless have reviewed our most recent examination reports—some of which may date back for a year or so—to determine the extent to which concentrations of holdings of New York City or State securities may exist among our State member banks. I am submitting a staff report summarizing this study for the information of the committee. It shows that only 6 of our roughly 1,100 State member banks held New York City securities amounting to more than 50 percent of the bank's capital as of the last examination; in some cases, these positions may well have been reduced or eliminated since that time. If holdings of New York State and State agency issues are included as well, the number of banks with such investments aggregating more than 50 percent of their capital is raised to only 17; most of these are quite small institutions.

It does not appear, therefore, that there is a significant threat of capital impairment, at least among the State member banks. The studies conducted by the Comptroller of the Currency and the Federal Deposit Insurance Corporation, I believe, reach more or less similar conclusions. A more likely possibility is that, in the event of default by the city, some banks will experience a temporary liquidity squeeze—arising, for example, from sudden shifts of deposits from one bank to another, or because banks are faced with unexpected requests for credit accommodation by their municipalities, or by holders of the defaulted bonds, or by dealers in the municipal securities market who for a time may be unable to liquidate their inventories of bonds.

In the event that such a temporary liquidity squeeze should develop, the Federal Reserve has ample power to provide additional funds to its member banks—and to nonmember institutions when other sources of funds are not available—through loans at the Federal Reserve bank discount windows. The board has adapted its contingency plans to deal with such an emergency, and I want to assure you, as Chairman Burns has done before other committees, that we are prepared to act promptly and in whatever scale is deemed necessary to assure an orderly financial environment. We recognize that such special extensions of central bank credit might have to be sizable and could risk a substantially larger expansion in money and credit than is desirable over the longer run. Such credit accommodations would therefore have to be of a temporary character, and would need to be reversed later on, but they nevertheless would be made readily available in an emergency situation.

I do not want to suggest that a default by New York City would not be a very serious matter for financial markets as well as for the city. But I do believe that the public need not fear for the stability of our banking system if a default does in fact take place. We have ample capability to provide the liquidity that the financial system may need in such a time of crisis—liquidity which, when supplied in timely fashion and adequate amounts, should help confine the damage in the municipal securities markets to only those who are most directly involved.

## ATTACHMENT I

COMMERCIAL BANK HOLDINGS OF STATE AND LOCAL GOVERNMENT DEBT  
(End of year totals except where indicated)

Year	State and Local Government Debt Outstanding		Total	Commercial Bank Credit	
	Amount (\$ billions)	Bank Share (Per Cent)		Holdings of State & Local Government Debt (\$ billions)	State & Local Debt Share (Per Cent)
1960	70.8	25.0	203.7	17.7	8.7
1965	100.3	38.8	310.4	38.9	12.5
1970	144.4	48.6	459.2	70.2	15.3
1975 (6/30/75)	216.2	47.3	708.9	102.3	14.4

Increase from 12/60 to 6/30/75	Amount (\$ billions)	Per Cent Increase
State & Local Govt. Debt Outstanding	145.4	205.4
Commercial Bank Holdings of State & Local Govt. Debt	84.6	478.0
Bank share of Increase in State & Local Debt Outstanding		58.2

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Source: Federal Reserve Flow-of-Funds Accounts.

ATTACHMENT IIREPORT OF A SURVEY OF SIGNIFICANT STATE  
MEMBER BANK HOLDINGS OF THE OBLIGATIONS  
OF NEW YORK CITY, NEW YORK STATE, AND  
NEW YORK STATE AGENCIES

September, 1975

In order to determine the potential exposure among State member banks to adverse developments in the market for municipal and State obligations of New York, each Federal Reserve Bank in August of this year was requested to provide information about State member banks which held concentrations of New York City, New York State, or New York State Agency securities as of the last examination report. For this purpose, a concentration was defined as holdings amounting to more than 10 per cent of a bank's capital for any of the three groups, or to more than 20 per cent of capital for the three groups combined. Principal New York State agencies included the Housing Finance Agency, the College Dormitory Authority, and the Urban Development Corporation.

The selection of the 10 per cent lower cutoff of holdings of a single group of securities relative to capital was made in view of the fact that loans to a single borrower are normally limited to 10 per cent of capital. While the limitation does not specifically apply to a bank's holdings of municipal securities, it was deemed appropriate for the purpose of assessing any possible points of potential bank exposure.

It should be noted that the data on securities were reported at par value, and were taken from examination worksheets on hand at the Reserve Banks that were not necessarily current but may date from as

long as a year ago. Over the intervening period, it seems probable that institutional holders had lightened their investments in New York obligations, on balance, especially since the Urban Development Corporation default on February 25, 1975. Moreover, the data on securities holdings were not broken down by maturities. Many holdings could have been short-term debt and by now have been liquidated.

Of the 1,064 State member banks, 130 or about 12 per cent of the total fell within the survey guidelines. Fifty-one of the banks reported are located in the State of New York. The remaining banks are scattered throughout the country.

Table I reflects data for 112 of the survey banks which held New York City obligations. Seventy-seven of these banks held debt of the City amounting to only 10 to 20 per cent of capital. Of the remaining 35 banks, six banks held New York City debt amounting to over 50 per cent of capital; but five of the six were smaller banks--with less than 10 million in total capital.

When holdings of New York State and New York State Agency obligations are added to the analysis, the majority of banks fell into the 20 to 50 per cent of capital category as shown in Table II. This shift is primarily due to significant holdings of New York State debt. Seventeen banks were reported with total New York City, New York State, and New York Agency obligations greater than 50 per cent of capital. However, 15 of these banks, again, were smaller banks--with less than 10 million in total capital.

On the whole, the State member banks with holdings of New York obligations reported in the survey were rather small in size. Moreover, the percentages of capital reported do not represent cause for alarm and, as previously indicated, the incidence of potential exposure has probably decreased since the last examination. In the view of the Division of Bank Supervision and Regulation, though there were a few State member banks with holdings of New York obligations representing relatively high percentages of capital, the situation on the whole appears to be quite manageable.

TABLE I. DISTRIBUTION OF STATE MEMBER BANKS  
BY CAPITAL ACCOUNT AND BY HOLDINGS OF NEW  
YORK CITY OBLIGATIONS AS A PER CENT OF CAPITAL

Capital Account (In millions of dollars)	New York City Obligations as Per Cent of Capital		
	10-20%	20-50%	Over 50%
	(Number of banks)		
Less than one	9	12	2
1 to 10	46	12	3
10 to 25	8	--	--
Over 25	14	5	1
Totals	77	29	6

TABLE II. DISTRIBUTION OF STATE MEMBER BANKS  
BY CAPITAL ACCOUNT AND BY HOLDINGS OF TOTAL  
NEW YORK CITY, NEW YORK STATE, AND NEW YORK  
STATE AGENCY OBLIGATIONS AS A PER CENT OF  
CAPITAL

Capital Account (In millions of dollars)	Total New York City, New York State, and New York State Agency Obligations as Per Cent of Capital		
	10-20%	20-50%	Over 50%
	(Number of banks)		
Less than one	5	14	5
1-10	31	37	10
10-25	2	6	--
Over 25	3	15	2
Totals	41	72	17

Statement of Arthur F. Burns, Chairman, Board of Governors of the Federal Reserve System Before the Joint Economic Committee, October 8, 1975

I am here to join you in discussing the economic and financial problems posed by the financial crisis of New York City.

The difficulties now facing New York stem from the erosion of its financial position over the past decade. During this period the expenditures by the City's government grew rapidly while revenues failed to keep pace. To close the gap between its revenues and expenditures, the City relied increasingly on borrowed funds. Not only capital expenditures, but also the mounting deficits on current operations, were financed in this fashion. By the end of 1974, New York City's outstanding debt amounted to over \$13 billion, much of which was in the form of short-term notes -- that is, obligations maturing in a year or less.

Investors may learn slowly, but their innocence does not last forever. As poor management of New York finances persisted, at first a few but in time more and more investors became concerned about the City's financial condition. During the past winter and spring the City began to experience very serious difficulties in rolling over its debt -- to say nothing of adding to its outstanding indebtedness.

Unfortunately, the City failed to take clear-cut remedial measures, and there was some loose talk about an investor conspiracy against the City. The basic facts, of course, were quite simple. First, commercial bankers, being aware of their responsibility for other people's money, felt they may already have approached -- if not exceeded -- the limits of prudence in their holdings of New York City securities. Second, the many thousands of individuals who invest on their own account likewise focused on safety; they were no longer much tempted by promises of an exceptionally high yield. Investor confidence in the City's finances thus dwindled, while its need to pay current bills and to refinance maturing obligations became more pressing. Once this stage was reached, the possibility of default on the City's obligations became very real, and it was so advertised almost daily in our nation's newspapers.

The financial crisis confronting the nation's largest city prompted the government of New York State to offer financial and managerial assistance. Starting in April, the State put at the City's disposal substantial sums that were not scheduled for payment until some months later. Then, around mid-June, the State legislature created a new agency -- the Municipal Assistance

Corporation (MAC). This agency was empowered to sell up to \$3 billion of its debt obligations, which were to be backed by certain tax revenues that otherwise would have gone to the City, and then to make the proceeds of its borrowing available to the City. Armed with such broad authority, MAC sought to wring some clarity out of the City's tangled finances and to help develop a budgetary plan that could lead the City back to a balanced budget.

These measures, however, proved insufficient to restore investor confidence in the City's financial management, and even the new securities issued by MAC soon came under a cloud. To ward off imminent default by the City of New York, the State adopted firmer measures on September 9. First of all, control of the City's finances was turned over to a State-dominated Emergency Financial Control Board. Second, the power of MAC to issue debt securities was enlarged. Third, the State sought to arrange additional financing of \$2.3 billion for the City, of which \$750 million in loans was to be provided by the State. This financial plan was designed to tide the City over until early December, and it was hoped that by that time the newly organized Control Board would have in being a sufficiently

strong program of budgetary restraints to enable the City to resume the sale of its securities to the investing public.

But when investor confidence is once shaken, it can rarely be restored quickly or easily. The new financial plan failed to elicit enthusiasm on the part of investors. In general, the financial community remained skeptical about the City's ability to avert default and rebuild its financial strength. The concern of market participants was heightened by a judicial ruling on September 29 that brought into question a portion of the financial aid package, namely, the purchase of MAC bonds by the State pension funds. Beyond that, the recent intertwining of the State's finances with the City's finances has troubled many investors and damaged the State's credit standing. Thus, the stresses and strains that developed in the municipal securities market over the summer months have become more acute in recent days.

Since the summer, and to an increasing degree in recent weeks, the participants in the municipal market -- that is, investment bankers, securities dealers, and ultimate investors -- have been attempting to reduce their exposure to the risk of loss. This has affected not only securities bearing a New York name,

but also issues of some other State and local governments. Thus, many securities dealers have sought to cut back on their inventory of municipal securities, and they have often found it necessary to offer bonds for sale at prices considerably below their purchase price. Underwriters of municipal issues have generally scaled back on their participation in new offerings, thereby protecting their capital in an uncertain and volatile market. Some underwriters have gone so far as to withdraw entirely from bidding syndicates. And investors -- the ultimate buyers of municipals -- have been tending to shift to higher-quality municipal securities or to categories of investment judged to be less hazardous.

Trading in the market for outstanding tax-exempt bonds has therefore slowed appreciably and the spread between bid and asked quotations has widened. These developments are characteristic of a period when investor confidence has been shaken, and they are indicative of a weakened market.

The recent behavior of investors and dealers has resulted in a rise of the yields on municipal securities to the highest level ever experienced in the tax-exempt market. Yields for even the highest-rated borrowers have risen over the past few months.

Some of this increase has been associated with the upward drift of open-market interest rates since mid-year. In addition, municipal yields have been under upward pressure because of the heavy volume of new tax-exempt issues flowing to market. The market for tax-exempt securities is more concentrated, and therefore smaller, than for taxable bonds. Hence, when unusually large amounts of such securities have to be placed, larger yield adjustments relative to taxable markets are likely to occur. Nevertheless, until the last two weeks, I would judge that the yields on the highest-rated municipal issues have not been out of line with those available on corporate bonds of comparable quality.

In choosing among tax-exempt securities, however, investors have become increasingly selective. The differences in yields, comparing lower-rated bonds with higher-rated issues, have increased considerably since last spring and have become unusually large. Thus, the average yield on Moody's A-rated bonds now exceeds that on Aaa-rated bonds by more than a full percentage point -- or about three times the risk differential required by investors during the preceding six years. Thus, the interest cost for lower-rated borrowers coming to market has risen materially.

The deterioration of the market for municipals of less than the highest quality has been especially pronounced for obligations of New York City, New York State, and certain of the State agencies. In the case of the State proper, investors have become concerned that the resources being diverted to the City are damaging the financial position of the State itself. Some of the State's agencies that issue "moral obligation" securities rather than "full faith and credit" obligations have been unable in recent months to finance themselves in the public market. There now appears to be some tendency on the part of investors to underestimate the financial strength of these agencies -- an attitude that stems at least in part from the temporary default earlier this year by the Urban Development Corporation. To a lesser extent, there has also been some reluctance by investors to acquire the securities of similar agencies in other States.

During the past week or so, the impact of the market's unease has spilled over to a wider range of securities. Significant increases in yields have occurred in the case of some outstanding bonds of governmental units that enjoy a high financial standing. Moreover, a few issuers have not received any bids for their

bonds, or have rejected the bids received because the interest cost was deemed excessive. These developments reflect increasing concern over the crisis of New York City.

If the weakness of the market for municipals were to persist and spread further, many soundly run, creditworthy communities and public agencies could have great difficulty -- or suffer excessive costs -- in raising needed funds. Holders of municipal securities, among which financial institutions are numerous, would to some degree be affected, and so might others less directly involved. Hence, if the New York City crisis remains unresolved, and if the fate of New York State remains tied to the City's, the process of economic recovery now under way in our nation could be injured.

Until this most recent turn of events -- which I trust will prove to be a transitory phenomenon -- the market for municipal securities, taken as a whole, functioned very effectively. During the third quarter of this year, even as pressures associated with the New York City problem intensified, new bond issues amounted to about \$9.5 billion. This is by far the largest volume ever for a third quarter, and it would have been a record even in the absence of the \$2.4 billion of MAC bonds sold during the period.

In seeking ways to resolve New York City's crisis, the suggestion has occasionally been advanced that the Federal Reserve might serve as a source of emergency credit. No formal application for such credit was ever received by the Board or the Federal Reserve Bank of New York. But I want to explain why we probably would have disapproved such an application had it been made.

As the ultimate source of financial liquidity in the economy, the Federal Reserve has certain powers to extend emergency credit even to institutions that are not members of the System. But the use of that authority is tightly circumscribed. The basic provision -- contained in Section 13, paragraph 13, of the Federal Reserve Act -- states that emergency loans with maturities no longer than 90 days may be made by the Federal Reserve Banks on the basis of promissory notes backed by Treasury or Federal agency securities. To qualify for credit assistance under this provision of law, a local government would have to possess sizable amounts of unencumbered Federal obligations. This would be an unusual situation for any distressed borrower and it obviously does not apply to New York City.

The lending authority under paragraph 3 of Section 13 of the Federal Reserve Act is broader, permitting the Board, in unusual and exigent circumstances, to authorize Reserve Banks to make loans on the kinds of collateral eligible for discount by member banks. Such paper may not have a maturity of more than 90 days and must afford adequate security to the Reserve Bank against the risk of loss. Furthermore, in view of restrictions of law and Congressional intent, certain conditions must be met in order to permit the extension of emergency credit under this authority. Among these conditions is a requirement that an applicant has exhausted other sources of funds before coming to the Federal Reserve, that the borrower is basically creditworthy and possesses adequate collateral, and that the borrower's need is solely for short-term accommodation. It does not appear that New York City is now in a position to meet all these requirements. Certainly, its finances would hardly permit early repayment of emergency borrowings.

In addition to the emergency lending provisions in Section 13 of the Federal Reserve Act, the Reserve Banks have authority under Section 14(b) to purchase short-term obligations of State and local governments issued in anticipation of assured

revenues, subject to regulations by the Board. Legislative history indicates that this authority was designed to assist the Federal Reserve Banks in meeting their operating expenditures, and also to enable them to make the discount rate effective when little borrowing took place at the discount window. There is nothing in the Federal Reserve Act or its legislative history to suggest that Section 14(b) contemplated the purchase of municipal securities as a means of aiding financially distressed communities.

The Congress, of course, could amend the Federal Reserve Act so as to relax the requirements for extending Federal Reserve credit to financially troubled governmental units. But the Board of Governors would have the gravest doubts about any such action. If loans were to be made to State or local governments, the Federal Reserve would have to involve itself in the activities of these governmental units, including particularly their expenditure budgets and the adequacy of their revenues. Moreover, since numerous demands for credit might ensue, the Federal Reserve would have to set standards of eligibility. Being thus placed in the position of having to allocate credit among governmental units, the nation's central bank would inevitably become subject to intense political

pressures, and its ability to function constructively in the monetary area would be undermined.

The Board fully recognizes that the Federal Reserve System has the responsibility, subject only to restrictions under existing laws, to serve as the nation's lender of last resort. Over the years, we have therefore developed contingency plans to deal with possible emergency situations. As I previously informed the Chairman of this Committee, our plans have been adapted recently to cope with the financial strains that might be associated with the default of a major municipality.

In that event, I assure you, the Board is prepared to act promptly. The contingency plan calls for lending to commercial banks through the Federal Reserve discount window beyond the amounts required by normal discounting operations. Credit provided in this manner would assist banks in meeting their temporary liquidity needs. Not only that, the proceeds of the special loans made at the discount window could also be used by the banks to assist municipalities, municipal securities dealers, and other customers who are temporarily short of cash because of unsettled conditions in the securities markets. In addition, the System would, of course, be ready to use its broad power to stabilize markets through open market purchases of Treasury or Agency securities.

In the event this contingency plan has to be activated, the Board will make funds available on whatever scale is deemed necessary to assure an orderly financial environment. The Board recognizes that sizable extensions of Federal Reserve credit would run the risk of leading to a substantially larger expansion of bank reserves and the money supply than is consistent with longer-run monetary objectives. Clearly, therefore, any such expansion must be only temporary. In time, any excessive growth in bank reserves would need to be corrected through offsetting open market operations and through repayment of bank borrowing from the System.

There are also certain supervisory and examination questions that may arise with respect to banks in the event of a major municipal default. In this connection, the Board and other regulatory agencies have plans to revise procedures that apply to the valuation of defaulted securities, so that any write-downs may be postponed until the market has had a few months to stabilize and thus provide more reliable indications of their value.

Even so, a default may ultimately require writedowns that could seriously impair the capital of some banks. In that event,

the Federal Deposit Insurance Corporation has statutory powers to assist Federally insured banks that might find their capital impaired by a decline in the value of securities in their portfolio. I understand that the Corporation is prepared to implement, with appropriate safeguards, its contingency plans for dealing with insured banks that require a temporary infusion of supplemental capital for the above reason.

I think it evident from the far-flung scope of our contingency plans that we believe a default on debt obligations by New York City could produce serious strains in securities markets. For a time, it could also adversely affect municipalities that need to issue new debt. The like is true of financial institutions that hold such securities in significant volume, and also of individual investors who have part of their life savings at risk in these bonds. I still believe that the damage stemming from a prospective default by New York City is likely to be short-lived. Indeed, the possibility of such a default has already been discounted to an appreciable degree by the market. But I am also aware of the uncertainty that inherently attaches to a judgment on this score; and I recognize that a default, besides being a very serious matter for the City and State of New York, could have troublesome consequences for the nation at large.

The very fact that this Committee and other committees of the Congress are holding hearings on New York City's finances implies that concern is spreading that a New York default may injure the economic recovery now in process. I have said enough to indicate that I feel this possibility can no longer be dismissed lightly. That, however, does not ease the task that the Congress faces in dealing with the New York problem; for the precise issue is whether Federal financial assistance to New York may not cause national problems over the long run that outweigh any temporary national advantage.

As this matter is debated by the Congress, the adverse effects of a New York City default will undoubtedly receive full attention -- as they indeed should. I would only urge that the longer-run risks also be considered thoroughly. A program of Federal assistance to the City may well lead to demands for similar assistance for other hard-pressed communities, even those whose distress was brought on by gross negligence or mismanagement. Substantial Federal credit -- whether through insurance, guarantees, or direct loans -- would compete directly with the already huge amounts of Federal financing needs. Most important of all, the provision of Federal credit for local government will necessarily inject a major Federal presence in local spending and taxing decisions.

It is highly important, therefore, to recognize that the issue of assistance to New York City goes to the very heart of our entire Federal system of separation of powers -- a system that, despite enormous economic and social changes, still prevails in our country.

The CHAIRMAN. Thank you, gentlemen, very much for a most helpful and expert report on what the situation is with the banks and what effect a New York City default or a New York State default too might have on our banking system and on our banks.

Mr. SMITH, you say on page 7 there are 93 banks with holdings exceeding 50 percent of capital measured by holdings of New York City and State obligations against gross capital funds. Is this simply their capital? You say "gross capital funds." How do you use that term?

Mr. SMITH. Yes. I am referring to their equity accounts, their profits and their reserve for loan losses.

The CHAIRMAN. I notice that 50 banks with assets of \$6 billion, presumably some of these banks are pretty large, have 50 percent to 100 percent holdings of New York City's obligations equivalent to 50 percent of their gross capital funds.

Mr. SMITH. Yes, sir.

The CHAIRMAN. City and State?

Mr. SMITH. Yes. City and State.

The CHAIRMAN. And two banks have holdings that exceed their gross capital funds by double. In words, 200 percent.

Mr. SMITH. Small banks.

The CHAIRMAN. If you take admittedly the conservative assumptions Mr. Wille took, I agree with Mr. Wille's description of it and with what Mr. Mitchell said, too, in the event of default you probably would lose 50 percent to 75 percent. But let's assume you do lose 50 percent. What happens first to the banks that have, say, 100 percent—I should say holdings of New York obligations equivalent to their entire gross capital?

Mr. SMITH. Mr. Chairman, if I may refer back to table 1, if I may use that in answer to your question, we did, in fact, try to make a qualitative judgment of impact, using a sort of worst-case assumption.

Those nine banks listed, this is the table at page 4, holding of New York City's alone, those nine banks which we had in Group One, we felt insolvency was a distinct possibility. My recollection is that eight of those nine banks had holdings representing in excess of 100 percent of their capital accounts.

The CHAIRMAN. Now, how big would that be, if you included New York State?

Mr. SMITH. If we included New York State, we would go to page 7 and we have their 22 banks which have combined holdings of 100 percent or more. I think it is fair to conclude that, with a very deep value impairment, over the long-term, those banks would be in serious trouble. It is conceivable, if they had strong taxable income, both before, and if they had good earnings performance, it is conceivable that some with capital support could work their way out, but I think the odds would be strongly against them.

The CHAIRMAN. In other words, you are saying that some, up to 22, perhaps 20 banks, might fail?

Mr. SMITH. That is assuming a serious impairment of value, long-term, of both New York City and New York State holdings.

The CHAIRMAN. What are the assets of those banks?

Mr. SMITH. The assets of those banks are a little in excess of \$1 billion.

The CHAIRMAN. All right. Mr. Wille, I take it, and I tried to follow you as closely as I could, you had a very fine comprehensive statement, you would seem to feel you have no banks under your jurisdiction that would be in jeopardy this serious; is that correct?

Mr. WILLE. No, sir. I don't mean to imply that.

The CHAIRMAN. About how many would be comparable to the 22 that Mr. Smith told us about?

Mr. WILLE. That is, in serious need of additional capital?

The CHAIRMAN. That is right.

Mr. WILLE. I would view that number to be fairly close to 30. It would be under 30, but somewhere around that figure.

The CHAIRMAN. How much capital involved? I should say how much assets involved?

Mr. WILLE. The assets involved, I would like to verify this for the record, but I believe it would be less than \$1 billion.

The CHAIRMAN. You can't give us a ballpark figure for those, or can you? For 30 banks?

Mr. SMITH. If I can make this point, Mr. Chairman; 22 national banks have assets of slightly more than \$1 billion. I think it is unlikely that 30 State nonmember banks would exceed that asset total.

Mr. WILLE. I would subscribe to that view, Mr. Chairman. I think it will prove to be substantially less than \$1 billion, but I don't want to attach myself to any figure now.

The CHAIRMAN. I understand that.

[Mr. Wille subsequently verified for the record that the total assets of the approximately 30 nonmember banks which might need FDIC capital assistance in the event of default by New York City, New York State, and all New York State agencies amounted to \$908 million. Twenty-two of those banks are below \$25 million in individual asset size.]

The CHAIRMAN. Mr. Mitchell, what number of banks and what are their total assets in this category where they would be seriously jeopardized to the point of perhaps failing?

Mr. MITCHELL. I would say that perhaps none would be seriously jeopardized.

The CHAIRMAN. They are not jeopardized to the extent State, nonmember, and national banks are?

Mr. MITCHELL. I wouldn't say that. There is the loss of principal which is what you are talking about, I believe. There is also a loss of liquidity. A loss of liquidity, I think, can be met through Federal Reserve discount facilities. There also may be a loss of earning capacity. Maybe these assets will not earn interest for a year or two. That is a relatively short time.

The CHAIRMAN. I don't want to paint an alarmist picture. Are you saying that, because the Fed would be able to move in somehow and provide assistance under these circumstances?

Mr. MITCHELL. The numbers of State member banks I gave you were 6 and 17. I don't think I would regard any of those banks as being jeopardized by virtue of a possible New York City default.

The CHAIRMAN. Well, now is this because the Fed has been doing a different job of supervision than the other two regulatory agencies? Or a difference, in your judgment?

Mr. MITCHELL. I think it is a difference in judgment, yes.

The CHAIRMAN. Now, would you feel that in the event your judgment was not correct, and that these banks did become, did move into serious difficulties, would the Fed be in a position to assist and prevent failure, insolvency?

Mr. MITCHELL. Well, the Fed is in a position to deal with a loss of liquidity. It is prepared to do that for national banks, as well as members and if nonmembers can't obtain funds, to do the same for them. I think illiquidity is the major threat the New York default implies. If you meet that threat, then I think the banking system is secure.

The CHAIRMAN. Well, just give me the asset figures, if you have them, on the 17 banks that have over 50 percent of their holdings in New York City, State, or agency obligations. That is on the last page of your statement, table 2.

Mr. MITCHELL. I am looking in the table. That was in the testimony. There are no asset numbers on there.

The CHAIRMAN. Will you get that and provide it for the record?

Mr. MITCHELL. I can supply that to you.

[The following information was subsequently submitted by Governor Mitchell for the record:]

The 17 banks that held obligations of New York City, State, and State agencies in excess of 50 percent of capital had combined assets of \$1.8 billion as of June 1975.

The CHAIRMAN. Even though default might not lead to massive bank liquidity and capital problems, could it affect or would it be likely to affect, in your judgment, gentlemen, their lending practices and their investing practices? How, in your judgment, would a default by New York affect these banks investment in municipal bonds, for example, overall?

Mr. Mitchell, first.

Mr. MITCHELL. Banks are by far the largest single customer that the municipalities have. And to the extent that they think that their ownership of municipals is going to weaken their asset position, or cause people to believe that their asset position is being weakened by the holding of those securities, the banks will shy away from them for a time. That is inevitable.

The CHAIRMAN. For how long would you think a default by New York and New York State would do this?

Mr. MITCHELL. Well, you referred to the Detroit situation. If I recall correctly, Detroit defaulted about the time of the bank holidays, and I think it was about a year and a quarter before they had rescheduled those payments.

The CHAIRMAN. I am not talking about New York alone. I am talking in general, about all the municipals in the country. How long would banks tend to shy away from municipals?

Mr. MITCHELL. Unless there is a change in market psychology, who knows? It might be a year. It might be 2 years. It could be even longer. On the other hand, it might not be that long.

You were saying earlier that there was some testimony here about quality differentials. There are poor quality municipal issues as well as good quality issues. In the event of a default, banks as well as other investors might tend for some period of time to shy away, in my opinion, from poor quality municipals, but they might still be inclined to buy good quality municipals.

The CHAIRMAN. In view of the fact that municipals, if they shied away from municipals over the next year or so would that have a substantial effect, say, in the range of 1 to 2 percent, in the yield of these obligations? Does the yield increase that much, and the prices drop with that big customer cutting his purchasing?

Mr. MITCHELL. I am not the best man to answer that question. I would say it would have that impact.

The CHAIRMAN. What effect would default have on the lending practices and buying practices, in your judgment?

Mr. WILLE. I think banks would be clearly more cautious about the way in which they reacted to municipalities with respect to borrowing, to those issuing securities, to bankers who were significant suppliers to municipalities, depending upon the municipality in question. I would like to think bankers would be discriminating as to their judgments on a municipality-by-municipality basis.

The CHAIRMAN. We have found out the yield on even the top-rated, highest quality municipals has increased sharply with respect to corporate bonds, for instance, over the past 2 or 3 months, even the top rated. There has been no flight to quality, in that sense. They have all moved up in yield in relationship to corporate bonds. Wouldn't that be likely to continue, even though New York defaults, that the whole municipal bond market would be likely to suffer some?

Mr. WILLE. That clearly might be the result, but I feel this is one area in which I can't reasonably give you a market judgment.

The CHAIRMAN. Would you say there would be an increase like 1 or 2 percent in yield in the next year, if New York City defaults?

Mr. WILLE. I would say it would depend on a great number of factors.

Mr. MITCHELL. I was going to say, I think we do have a document that shows the yield relationships that I might append to my statement—municipals in comparison with corporate.

[The information referred to follows:]

## SELECTED MEASURES OF RISK PREMIUMS

[In basis points]

	Medium grade commercial paper less high-grade paper <sup>1</sup>	A municipal bonds less Aaa municip- al bonds <sup>2</sup>	Baa corporate bonds less Aaa corpo- rate bonds <sup>3</sup>	A corporate bonds less Aaa corpo- rate bonds <sup>3</sup>	A utility bonds less Aaa utility/ bonds <sup>4</sup>	NYSE index AMEX index (ratio)
1969-74:						
Average.....	37	36	95	50	39	0.487
High.....	<sup>8</sup> 169	<sup>6</sup> 67	<sup>7</sup> 164	<sup>8</sup> 97	<sup>8</sup> 131	<sup>9</sup> 595
Low.....	<sup>10</sup> 12	<sup>11</sup> 20	<sup>12</sup> 63	<sup>13</sup> 28	<sup>13</sup> 15	<sup>14</sup> 352
1975:						
January.....	150	74	179	92	114	.564
February.....	160	60	181	85	99	.558
March.....	140	51	162	66	108	.560
April.....	113	63	139	68	132	.547
May.....	82	70	156	89	128	.549
June.....	60	108	163	90	114	.543
July.....	78	111	149	79	135	.530
August.....	68	115	140	75	140	.533
September.....	63	111	143	79	131	.534
October.....	.....	.....	.....	.....	.....	.....
November.....	.....	.....	.....	.....	.....	.....
December.....	.....	.....	.....	.....	.....	.....
Week ending:						
Sept. 19.....	63	110	141	76	115	.534
Sept. 26.....	63	111	146	82	125	.537
Oct. 3.....	75	113	143	80	120	.538
Oct. 10.....	63	116	146	83	120	.552
Oct. 17.....	63	116	<sup>16</sup> 151	<sup>15</sup> 90	110	<sup>15</sup> 563
Oct. 24.....	75	120	<sup>18</sup> 155	<sup>15</sup> 92	110	<sup>15</sup> 574
Oct. 31.....	75	<sup>16</sup> 122	158	93	NA	.572
Nov. 7.....	.....	.....	.....	.....	.....	.....
Nov. 14.....	.....	.....	.....	.....	.....	.....
Nov. 21.....	.....	.....	.....	.....	.....	.....
Nov. 28.....	.....	.....	.....	.....	.....	.....

<sup>1</sup> Data based on information from 2 major dealers.<sup>2</sup> Based on Moody's Investor Service yield series for newly-issued bonds.<sup>3</sup> Based on Moody's Investor Service yield series for seasoned bonds.<sup>4</sup> Salomon Brothers estimated new issued yield series, available from September 1970.<sup>5</sup> October 1974.<sup>6</sup> November 1974.<sup>7</sup> December 1974.<sup>8</sup> July 1974.<sup>9</sup> June 1973.<sup>10</sup> Multiple dates.<sup>11</sup> November 1973.<sup>12</sup> April 1974.<sup>13</sup> June 1970.<sup>14</sup> January 1969.<sup>15</sup> Revised.

The CHAIRMAN. Mr. Smith?

Mr. SMITH. Mr. Chairman, I don't think I have any important professional judgment. I am certain that while the high wire act continues, there has to be a bit of uncertainty that is causing all potential purchasers of municipals to be more cautious, more discriminating.

On the other hand, if default by the city of New York resulted in banks and other investors in municipals, in effect, studying out of that market for a year or 2, I think it would be well-advised to take a look at the municipal marketplace.

The CHAIRMAN. Is it possible, in view of the great size of the New York obligations, relative to the municipal bond market as a whole, is it possible the municipal bond market might improve with that competition gone? Guaranteed New York securities would be a different instrument, obviously. If it is guaranteed it would be competing with the tax-free municipal obligations of other cities.

Mr. SMITH. Mr. Chairman. I have heard it said by market experts, and I want to underline that I certainly am not one, that if that tragic event occurred, once the market gets a better idea of what New York City was going to do to rearrange its affairs, clearing up of that uncertainty might cause it to function more efficiently. I have no judgment as to the correctness of that.

The CHAIRMAN. One other question. Let me ask either one of you gentlemen, did your agencies in examining the banks raise any questions in the past 5 years or 3 years, last year, 6 months ago, about portfolio holdings of New York securities? And did you or your examiners suggest selling of these securities?

Mr. Mitchell?

Mr. MITCHELL. I would have to say, my impression is that we have not, but I would have to ask somebody on our staff. If so, it was not an official act by the Board.

[The following information was subsequently submitted by Governor Mitchell for the record:]

Within the last year, during the conduct of bank examinations, a few examiners have classified New York securities. They have rated such securities as not being of top quality. However, they would not have suggested selling such securities since that is a decision for the bank management.

The CHAIRMAN. Mr. Wille?

Mr. WILLE. With respect to individual banks which might have had a very heavy concentration in New York City obligations, it was likely—in a number of examinations, our examiners would have said, “We believe you have an overconcentration in New York City obligations,” but this was not intended to be a criticism of the quality of New York City obligations but rather of the particular bank’s investment policy of putting too many eggs in one basket. I am referring to non-member banks whose holdings are a significant portion of their capital. We did not ask banks to withdraw from New York City market by any means and, in fact, we are very much, in our examination process, tied in with the rating services. Until just recently, when the ratings of New York City obligations were lowered by Moody’s, we would have considered New York City obligations to be of investment grade for nonmember banks.

The CHAIRMAN. How are you and your examiners now viewing holdings of New York City and State obligations?

Mr. WILLE. We are not at the current moment classifying such holdings adversely, although we are listing them for special mention and special attention by bank boards of directors.

The CHAIRMAN. Are you taking any policy position with respect to securities of other cities?

Mr. WILLE. No, sir. Because I don’t believe right now any are in imminent danger of default. Obviously, again, if there is a heavy concentration we would be listing them for special attention by bank boards of directors. This is a policy that we have discussed among the agencies, but since Moody’s New York City rating was dropped only about 10 days or 2 weeks ago, we have not completed our interagency discussion as to how to handle that particular drop in rating for New York City.

The FDIC has basically instructed its examiners to stay in a holding pattern while the efforts that are being made, both at the city level

and at the Federal level here, are resolved. Thereafter, we will have a much better picture of appropriate instructions.

In short, we have not wanted to unsettle the market any further and we are awaiting the outcome of the next 4 to 6 weeks.

The CHAIRMAN. Mr. Smith?

Mr. SMITH. Like the FDIC, Mr. Chairman, we rely heavily on the rating agencies for quality ratings of municipals. We have no general office policy with respect to quantitative holdings, although some of my examiners have criticized some banks on a concentrated basis. I think where we see holdings reflecting 200 percent of the capital accounts, that those criticisms are well justified. We are reviewing that policy right now, as to whether or not we should endeavor to establish some administrative standards on quantitative levels.

The CHAIRMAN. Mr. Javits.

Senator JAVITS. Thank you, Mr. Chairman.

Gentlemen, I assume the assumptions upon which you are proceeding included New York City securities, New York State securities, so-called full faith and credit securities, and New York State agency moral obligations, altogether. Is that correct?

Mr. MITCHELL. Yes.

Mr. WILLE. That is correct, sir, as far as the FDIC is concerned.

Mr. SMITH. Senator Javits, we in our qualitative assessment have made no assumptions about New York State. We have identified them. We feel there are so many more imponderables in the New York State situation, that we find it difficult to make even an arbitrary assumption in that case.

Senator JAVITS. The other thing I want to ask you especially, Mr. Mitchell, have you got any agreement with the accountants who do these audits and bank statements, et cetera, or of the SEC, if they get into the act, that they are going to treat these investments the same way the Federal Reserve is going to look at them? Not require a markdown, et cetera?

Mr. MITCHELL. Well, both the banking agencies and the SEC on the 1st of October published a proposal, having to do with the disclosure requirements by the banking agencies and the SEC, and a period for comment expires the 1st of November, and I am hopeful that the differences that existed will be worked out.

Senator JAVITS. So right now there is not necessarily a consistent policy with the accounting profession. Doesn't that insert also an element of risk?

Mr. MITCHELL. I suppose it does.

Senator JAVITS. That is true, isn't it?

Mr. SMITH. Certainly in terms of disclosure, and liquidity problems, we happen to think that our judgment of permitting a reasonable period to occur after the event of default is a sound one. We would hope that the accountants and the SEC would be persuaded of the wisdom of that judgment.

Senator JAVITS. But that is not yet the fact. So, you could have differences of opinion from those quarters. That is correct. You all agree. I am very interested in your statement, Mr. Mitchell, in which you say on page 5, "I would not want to suggest that a default by New York City would not be a very serious matter for any financial market as well as the cities."

We know about the cities. How about financial market? What does that mean? You say, "I do feel the public need not fear for the stability of our banking system."

I don't believe anyone fears for the stability of our bank system but what do you mean by the financial market?

Mr. MITCHELL. We have been talking about the impact default would have on the municipals market. That presumably will communicate itself to other markets. That is what I had in mind.

Senator JAVITS. You do consider it a serious matter?

Mr. MITCHELL. Certainly.

Senator JAVITS. In other words, there would be serious danger to both municipals and other financial markets?

Mr. MITCHELL. Yes.

Senator JAVITS. That is your considered judgment?

Mr. MITCHELL. Yes. Of course, it is also my judgment that we can deal with the financial market problem.

Senator JAVITS. That is insofar as bank stability. But you are not going to underwrite the losses for all kinds of investors?

Mr. MITCHELL. No. That is right.

Senator JAVITS. Now, the other question I would like to ask each of you. We are in a recovery phase of the economy now. What is a default by New York City, in your opinion, Mr. Smith, going to do to this recovery? Will it abort it? What do you think is going to happen?

Mr. SMITH. I don't think, Senator Javits, that one can offer any definitive conclusions without making some assumptions. Obviously, if you had a long-term value impairment of the entire municipal market, that has got to take its toll on the ability of the banking system to fund other credit requirements, but there are so many assumptions that could be made that I don't think I offered you a very helpful answer.

Senator JAVITS. As a bank examiner, do you regard an increase in interest yields—which the investor apparently requires—to represent a material impairment to the existing investments, which were issued at lower yields? In other words, the price—

Mr. SMITH. As the price moves up in the market, it obviously, in terms of your liquidity on existing portfolio, affects it.

Senator JAVITS. When you say price, you mean the return? You don't mean the price?

Mr. SMITH. In terms of your ability to liquidate holdings, obviously, as the rate structure moves up—

Senator JAVITS. If the rate structure goes up 2 points—

Mr. SMITH. You probably would be selling below your bank.

Senator JAVITS. You would have to carry it that way?

Mr. SMITH. No. We do not require the carrying of investments accounts at market. We do require the carrying of trading accounts at market. But the vast preponderance of these securities are held in investment accounts.

Senator JAVITS. So, you still carry them at the cost of your acquisition. That is for your agency. What about yours, Mr. Wille?

Mr. WILLE. This is the uniform position of the three Federal bank agencies. That would change, however, if there were a default on the part of the issuer involved.

Senator JAVITS. So, it would change as far as New York City is concerned. That would have to be written down.

Mr. WILLE. It would be written down with the delay we have been talking about here of several months.

Senator JAVITS. Which you haven't agreed on yet with the accountants or the SEC.

Mr. SMITH. That is right.

Mr. WILLE. That is correct.

Senator JAVITS. Don't you think it is a pretty worrisome practice, that you don't require a write-down of these investments, notwithstanding what a bank can get for them, if it wants to liquidate. All any bank can get is the market.

Mr. MITCHELL. I don't think anyone expects New York is going to disappear from the face of the earth. Ultimately these bonds—the amounts which have been borrowed and the interest thereon—will be paid back. It is going to result in a stretched-out schedule of debt repayment. In the meantime there may be liquidity problems, but as far as the assets are concerned, it is a sound asset.

Senator JAVITS. You, yourself, talk about recovery rates that may be as low as 50 percent.

Mr. MITCHELL. I didn't use that term.

Senator JAVITS. Somewhere in your statement you speak about it.

Mr. MITCHELL. I said the proportion of capital, the amount relating municipal securities to the amount of capital, that number is in there, yes, but the recovery I think I have been saying, I think it is going to be relatively small. Based on the experience we have had with defaults in the past.

The CHAIRMAN. You mean the recovery will be large and the loss will be small?

Mr. MITCHELL. Yes. That is right.

Senator JAVITS. I think you went a little further than that.

Mr. MITCHELL. Well, I shouldn't have.

Senator JAVITS. I am trying to find your statement here. Well, I will find it. I don't want to delay now.

The CHAIRMAN. Did you say since 1945 the loss has been about 1 percent?

Mr. MITCHELL. That is what the record shows.

Senator JAVITS. That is, ultimately they worked out?

Mr. MITCHELL. Yes.

Senator JAVITS. Thank you.

The CHAIRMAN. Thank you, Senator Javits.

Gentlemen, thank you very much. You have been most helpful.

The committee will stand in recess until 2:30 when we hear from a distinguished panel of bankers and others.

[Whereupon, at 1:30 p.m., the hearing was adjourned, to reconvene at 2:30 p.m. this same day.]

The CHAIRMAN. The committee will come to order.

Our witnesses this afternoon will be a panel of distinguished American bankers.

Mr. David Rockefeller, chairman of the board of Chase Manhattan; Mr. Elmore Patterson, chairman of the board of Morgan Guaranty; Mr. Walter Wriston, chairman, First National City Bank of New York; Mr. A. W. Clausen, president, Bank of America.

It is going to be a crowded table, I am afraid, because we would like to also have up at the table, if possible, Mr. Morris D. Crawford, Jr., chairman of the board of the Bowery Savings Bank of New York City; Mr. Stewart Rauch, Jr., chairman of the Philadelphia Saving Fund Society; and Mr. Harry W. Albright, Jr., president, Dime Savings Bank, New York.

Gentlemen, we are delighted to have you here.

Mr. Rockefeller, would you lead off?

**STATEMENTS OF DAVID ROCKEFELLER, CHAIRMAN OF THE BOARD, CHASE MANHATTAN; ELMORE PATTERSON, CHAIRMAN OF THE BOARD, MORGAN GUARANTY; WALTER WRISTON, CHAIRMAN, FIRST NATIONAL CITY BANK OF NEW YORK; A. W. CLAUSEN, PRESIDENT, BANK OF AMERICA; MORRIS D. CRAWFORD, JR., CHAIRMAN OF THE BOARD, BOWERY SAVINGS BANK, NEW YORK CITY; STEWART RAUCH, JR., CHAIRMAN OF THE BOARD, PHILADELPHIA SAVINGS FUND SOCIETY; AND HARRY W. ALBRIGHT, JR., PRESIDENT, DIME SAVINGS BANK, NEW YORK**

Mr. ROCKEFELLER. I would like to suggest that Mr. Patterson speak on behalf of the Chase Manhattan Bank.

The CHAIRMAN. As a fellow alumnus at J. P. Morgan Co.—I worked there, and had a worm's eye view back in the 1940's. I think you were there at the time.

Mr. PATTERSON. I recall being there with you, and I am glad you are one of our alumni.

The CHAIRMAN. You have done better, salarywise, than I have.

Mr. PATTERSON. I am trying not to be an alumnus too soon.

The CHAIRMAN. Go right ahead.

Mr. PATTERSON. Thank you.

Mr. Chairman, members of the committee, on behalf of Mr. Rockefeller, Mr. Wriston, and myself, we deeply appreciate your invitation to testify here today.

At the outset, Mr. Chairman, we would like to comment directly on a matter that members of this committee undoubtedly have very much in mind—namely, that the institutions we represent have a clear self-

interest in seeing that the financial affairs of New York City and New York State are stabilized.

By the simple fact of location and our financial responsibility to the community, we are deeply involved in the life of city and State.

It is common knowledge, of course, that we and other major New York City banks own substantial totals of New York City, New York State, and New York State agency securities—totals that have been enlarged in the course of our efforts over many months to contribute to a solution of difficulties.

Because of that, we appreciate that almost anything we say about the New York situation may be deemed to be self-serving.

We also appreciate that, as a practical matter, there is little we can say to dispel such a view on the part of any who may hold it.

Nevertheless, Mr. Chairman, we would like to state formally and for the record that narrow self-interest related to our portfolio holdings is not the reason we are here today.

The banks we represent are healthy institutions whose soundness has not been jeopardized by the acquisitions that have been made of city and State securities.

Our preoccupying concern—the one that brings us here today—is the likely trauma for New York, both the city and the State, if default is not avoided.

We believe that the disruptive effects of default in terms of individual human lives are potentially large—how large is a matter of judgment.

We do not want to see New York go through the unnecessary turmoil and distress that could follow a default.

Nor, as we shall discuss, do we want to see reverberations throughout the Nation and its economy.

You have already heard a great deal of testimony relating to the current financial problems of New York City and New York State. Consequently we do not devote any significant portion of this statement to additional elaboration. Our review of budgetary trends is limited to key points.

Prior to the current phase of budget strain, and going back well over a decade, New York City expenditures rose at an exceedingly rapid rate.

During the 1960's the expenditure increase was, to a large extent, sustainable because assistance from New York State and from the Federal Government grew very rapidly in line with the urban-oriented philosophy of that decade.

With the benefit of hindsight it is now clear to everyone that New York City expenditures should prudently have been more closely related to own-source revenue.

Even with outside assistance, the city tended to run in deficit, and the deficit position was greatly aggravated in the 1970's when growth in intergovernmental aid payments started slowing down.

The sheer momentum of expenditure rise was such that quick re-attainment of a condition of budgetary balance would have been exceedingly difficult even if efforts in that direction had been made with real determination.

As we now know only too well, efforts to achieve a matching of income and outgo were anything but determined. Poor management

of finances by the city itself inescapably bears heavy responsibility for present problems.

The fact of poor fiscal management is generally well known. What is less adequately appreciated is that national factors also have contributed materially to the budget problems of State and local governments—with New York City simply the extreme case.

The recent national recession—by far the most severe of the post-war period—squeezed State and local budgets in two ways.

It added to costs by enlarging the total of people needed income supplements of one kind or another, and it adversely affected the flow of receipts from income taxes and sales taxes.

At the same time, our extraordinary inflation problem—national and, indeed, international in origin—greatly intensified difficulties by raising virtually all State and local costs substantially without having a commensurate expansive effect on revenues.

Unlike the Federal Government, whose revenues tend to be highly responsive to inflation—in part because of the progressive rate structure for personal income taxation—municipal governments in particular tend to rely heavily on taxes based on property holdings and sales transactions that do not benefit as automatically from rising price levels.

The administrative adjustment upward of such things as real estate levies almost inevitably tends to lag behind the pace of inflation.

When the pace becomes a gallop, the lag becomes increasingly significant.

In New York City, the practical limits to achieving greater revenues by imposing higher real estate levies are very close at hand for many types of property.

Many States, to be sure—including New York State—do derive significant portions of total revenues from income taxes. That has made inflation's budget squeeze less severe at the State level.

The impact on New York City and other local communities of national and international events—and of national policy—certainly provides some justification for Federal involvement with what is happening.

We do not mean to suggest by that observation that New York can reasonably expect to look to other parts of the Nation to solve its problems.

New York City does bear prime responsibility for its situation and, in the long run, it properly should bear essentially the entire burden of correcting its troubles.

But the fact that the city's problems have been accentuated by national events deserves to be considered in weighing the question of whether some form of special, temporary stabilizing role for the Federal Government is appropriate in order to bridge the time gap until the effects of meaningful fiscal reform can materialize.

In stressing that national problems have played a role in accentuating New York City's difficulties, we are not unmindful of the adverse impact of national recession and national inflation on other municipalities.

The question of why New York City has been relatively more vulnerable to certain national problems—especially to the problem of recession—than other cities is extremely complicated.

Part of the answer, though, clearly lies in the unique character of the huge migrations, both in and out of the city, that have occurred in the postwar period—migrations that, in themselves, are exceedingly complex phenomena whose causes are not entirely of New York's making.

As you are well aware, the present problem of financial stress in New York—tracing back to the default of New York State's Urban Development Corporation last February—is no longer, unfortunately, confined to the city.

Despite a comparatively favorable budget record—and a good prospect for decided budget improvement if general economic recovery continues—New York State has seen its own credit worthiness questioned in the markets.

The rescue efforts of New York State on behalf of the city have impaired its standing in investors' eyes.

The State's problems, moreover, have been greatly complicated by the fact that most of its agencies are not able to market debt at this time.

We have now come to a point, in fact, where the securities of the entire State of New York, all its agencies, and many of its political subdivisions—not just New York City—are for all practical purposes being shunned by the national investment community.

As indicated in an exhibit we are appending, the prospective borrowing needs between now and next June 30 of all the entities involved—the city, the State, and all State agencies and subdivisions—appear to be upward of \$12 billion.

There is simply no way that anything like that, total of money can be raised without some degree of restoration of investor confidence.

It is important to realize that if default occurred—followed by a suspension of all debt service payments—it would be highly improbable that the ordinary business of the city could proceed at all normally.

Indeed, both the city and the State need to have access to debt markets not just to cope with debt maturities and debt servicing, but to be able to avoid sudden and fundamental disruption in the provision of basic services.

According to data compiled by the office of the New York City comptroller, in New York City alone the cash flow situation in the next 3½ months is so acute—as indicated in data appended to this statement—that even if the city could suspend all debt service payments—both principal and interest—it would still have a cash flow short-fall in excess of \$1 billion.

I might add, these figures were compiled before disclosure by Beame on October 15 of his intention to make further cuts in this year's budget, but the charges contemplated won't have much effect on these figures.

In other words, the city would be a full billion dollars short of being able to meet payments to its employees, its welfare recipients, and its suppliers.

The consequences of an inability by the city to meet expenses of such magnitude—equivalent to one-fourth of anticipated expenses excluding debt service during this period—could obviously be very severe.

The situation in the rest of the State—posed by the fact that debt markets are basically closed down—is also exceedingly worrisome in terms of potential disruption of services.

If New York State cannot borrow the \$2.5 billion in tax-anticipation funds that it would normally borrow next spring, that might well necessitate deferral of some considerable part of the aid flow to cities, towns, and school districts.

In that event serious adjustment problems would be inevitable widely throughout New York State, in all its communities, including New York City.

What the consequences will be elsewhere in this country—and, indeed, elsewhere in the world—if the New York situation cannot be stabilized or quarantined, is something we believe no one can be certain of.

The fact that voices from abroad are beginning to express serious worry testifies to the potential reach of default.

We are mindful, of course, that this committee has heard a range of judgments about the effects that might ensue from default. Our own conviction is that the potential consequences of any default are essentially unknowable before the event.

This is particularly so because there are no meaningful precedents to guide an assessment, and also because psychological considerations could be of such dominant importance.

What is particularly disturbing in a quantitative sense is the possibility of a markedly adverse psychological reaction in the consumer and business sectors of the economy.

Were that to happen, an enormous downpull on general economic activity would be exerted.

In the realm of State and local government matters there clearly would be a distinct possibility of an intensification of the adversity that already has been experienced for a wide range of borrowers as a result of unease over the New York situation—with the extreme danger being that some governmental units, in addition to New York City, New York State, and New York State agencies, would be unable to borrow on any terms at all.

Incidentally, we would note that it is not precisely clear how much of the recent movement that has so far occurred in the tax-exempt securities market can be attributed to worry about New York.

For the sake of balance, it is also worth mentioning in passing that by no means all State and local borrowers have suffered market adversity as a consequence of fallout from the New York situation.

Indeed, States and municipalities with exemplary financial records—in areas particularly of the South, Southwest, and the West—may even have gained relative benefit in the special quest investors are now making for high quality securities.

Making an unconditional judgment about the full scope and severity of the repercussions that might flow from default is simply impossible, Mr. Chairman, as you yourself noted in your opening statement on October 8.

Repercussions might be seriously troublesome to the national economy. Or they might be much more muted than the grimmer possibilities suggest.

However, the fact that neither we nor anyone else can know with certainty what the outcome of default would be seems critically relevant to the matter of whether this Congress should take some action.

No one of the three of us joining in this statement is disposed in principle to urge Federal Government involvement in the affairs of a State or municipality.

But in this instance, we find ourselves obliged to acknowledge that a Federal role is inescapable if default is to be avoided.

If one must think in terms of rescue funds running to many billions of dollars to help restore investor confidence, there clearly are not many avenues open.

Should this committee come to the judgment that Federal assistance is appropriate, we would urge a very careful structuring of any aid package.

We are firmly convinced the any kind of loan program, loan guarantee program, or insurance program that did nothing more than simply relieve the immediate cash-flow problems of a troubled local or State government, could be highly counterproductive over the longer term—counterproductive in the sense of pushing today's problem into the future, only on a larger scale.

Experience demonstrates very emphatically that we need to tighten, not loosen, safeguards against undisciplined use of public funds.

Simply making funds more readily available to a troubled governmental body would be a pointless step.

In this regard, we are encouraged that the various proposals that have come before this committee for creating a Federal mechanism for aiding troubled governmental units generally recognize in an explicit way the dangers that would be inherent in simply making it easier for funds to be secured.

The basic purpose of Federal assistance would be to afford time for a troubled governmental unit to restore its credibility in the marketplace.

The specific form of such assistance—whether direct loan, loan guarantee, or insurance—seems less important to us than the criteria that ought to guide any assistance effort. These basically are:

- (1) That stringent budgetary and repayment conditions be attached to the assistance;
- (2) That assistance be for the shortest timespan feasible;
- (3) That effective procedures be devised for continuous monitoring of the actual performance of recipient governmental bodies to make sure no slippage, intentional or otherwise, occurs in adherence to specified budgetary and repayment conditions;
- (4) That assistance be made available only after certification at the State level that all normal avenues of financing are closed both to the State and to a necessitous governmental unit and that default is threatened;
- (5) That applicable interest rates on any Federal loan or service charges on any guaranteed or insured loan be sufficiently unattractive to the borrower to discourage recourse to such assistance except under conditions of extremity;
- (6) That Federal assistance be extended only at the State level and only after a State has effective machinery in place for controlling the use of funds by a local governmental unit;
- (7) That no new Federal bureaucracy be created to oversee or administer an aid program; and
- (8) That any State or State agency obligation guaranteed or insured under an assistance program be fully taxable.

Such terms are not meant to be punitive. They are essential, rather, to minimizing the risk that the Federal Government could experience a loss as a result of extending temporary, emergency credit.

They also are essential to maximizing the chance that assistance would really facilitate early reopening of normal debt-marketing channels.

We would especially emphasize that some substantial portion of any sum lent, guaranteed, or insured be made available only for a limited term—say, up to 1 year—with renewal dependent on responsible self-discipline by the user of the funds.

For both safeguard and leverage purposes, specific provision should be made for tapping the stream of revenue-sharing funds flowing to a borrowing State in the event that a loan—whether made directly, guaranteed, or insured—was not repaid at maturity.

The basic enabling legislation presumably would have to provide for the use of the assistance by any one of the 50 States. As a practical matter, however, with strict criteria of the kind we contemplate, New York should be the only applicant.

Mr. Chairman, that essentially completes our prepared statement.

In closing, we would make just one further point; namely, that there would clearly seem to be a number of important legislative issues pertaining to State and local government affairs beyond those that can now be dealt with in the present emergency situation.

Previous witnesses in these hearings have offered widely differing interpretations as to why New York City has had difficulties much more severe than other municipalities.

At issue are allegations of unfairness relating to the Federal formulas for both revenue sharing and welfare support.

Also involved is the key matter of whether the Federal Government ought not to assume a greater share—and perhaps all—of the Nation's welfare-cost burden.

These are things that would seem to deserve very high priority by this and other committees of Congress.

Mr. Chairman, members of the committee, may we again express our appreciation for this opportunity to testify today.

The CHAIRMAN. Thank you very much. I understand you were speaking for Mr. Rockefeller and Mr. Wriston.

Mr. PATTERSON. That's correct.

[Joint statement of Messrs. Patterson, Rockefeller, and Wriston and accompanying documents follow:]

Joint Statement

of

Ellmore C. Patterson, Chairman of the Board  
Morgan Guaranty Trust Company of New York

David Rockefeller, Chairman of the Board  
The Chase Manhattan Bank N.A.

Walter B. Wriston, Chairman of the Board  
First National City Bank

before the

Banking, Housing and Urban Affairs Committee  
of the United States Senate

October 18, 1975

Mr. Chairman, Members of the Committee:

We deeply appreciate your invitation to testify here today.

At the outset, Mr. Chairman, we would like to comment directly on a matter that Members of this Committee undoubtedly already have very much in mind -- namely, that the institutions we represent have a clear self-interest in seeing that the financial affairs of New York City and New York State are stabilized. By the simple fact of location and our financial responsibility to the community we are deeply involved in the life of City and State. It is common knowledge, of course, that we and other major New York City banks own substantial totals of New York City, New York State, and New York State agency securities -- totals that have been enlarged in the course of efforts over many months to contribute to a solution of difficulties. Because of that, we appreciate that almost anything we say about the New York situation may be deemed to be self-serving. We also appreciate that, as a practical matter, there is little we can say to dispel such a view on the part of any who may hold it.

Nevertheless, Mr. Chairman, we would like to state formally and for the record that narrow self-interest related to our portfolio holdings is not the reason we are here today. The banks we represent are healthy institutions whose soundness has not been jeopardized by the acquisitions that have been made of City and State securities.

Our preoccupying concern -- the one that brings us here today -- is the likely trauma for New York, both the City and the State, if default is not avoided. We believe that the disruptive effects of default in terms of individual human lives are potentially large -- how large is a matter of judgment. We do not want to see New York go through the unnecessary turmoil and distress that could follow a default. Nor, as we shall discuss, do we want to see reverberations throughout the nation and its economy.

You have already heard a great deal of testimony relating to the current financial problems of New York City and New York State. Consequently, we do not devote any significant portion of this statement to additional elaboration. Our review of budgetary trends is limited to key points.

Prior to the current phase of budget strain, and going back well over a decade, New York City expenditures rose at an exceedingly rapid rate. During the 1960s, the expenditure increase was, to a large extent, sustainable because assistance from New York State and from the Federal government grew very rapidly in line with the urban-oriented philosophy of that decade. With the benefit of hindsight, it is now clear to everyone that New York City expenditures should prudently have been more closely related to own-source revenues. Even with outside assistance the City tended to run in deficit, and the deficit position was greatly aggravated in the 1970s when growth in intergovernmental aid payments started slowing down. The sheer momentum of expenditure rise was such that quick reattainment of a condition of budgetary balance would have

been exceedingly difficult even if efforts in that direction had been made with real determination. As we now know only too well, efforts to achieve a matching of income and outgo were anything but determined. Poor management of finances by the City itself inescapably bears heavy responsibility for present problems.

That fact of poor fiscal management is generally well known. What is less adequately appreciated is that national factors also have contributed materially to the budget problems of State and local governments -- with New York City simply the extreme case. The recent national recession -- by far the most severe of the postwar period -- squeezed State and local budgets in two ways. It added to costs by enlarging the total of people needing income supplements of one kind or another, and it adversely affected the flow of receipts from income taxes and sales taxes.

At the same time, our extraordinary inflation problem -- national and indeed international in origin -- greatly intensified difficulties by raising virtually all State and local costs substantially without having a commensurate expansive effect on revenues. Unlike the Federal government, whose revenues tend to be highly responsive to inflation -- in part because of the progressive rate structure for personal income taxation -- municipal governments in particular tend to rely heavily on taxes based on property holdings and sales transactions that do not benefit as automatically from rising price levels. The administrative adjustment upward of such things as real-estate levies almost inevitably tends to lag behind the pace of inflation. When the pace becomes a gallop, the lag becomes enormously significant. In New York City, the practical limits to achieving greater revenues by imposing higher real-estate levies are very close at hand for many types of property. Many States, to be sure -- including New York State -- do derive significant portions of total

revenues from income taxes. That has made inflation's budget squeeze less severe at the State level.

The impact on New York City and other local communities of national and international events -- and of national policy -- certainly provides some justification for Federal involvement with what is happening. We do not mean to suggest by that observation that New York can reasonably expect to look to other parts of the nation to solve its problems. New York City does bear prime responsibility for its situation, and, in the long run, it properly should bear essentially the entire burden of correcting its troubles. But the fact that the City's problems have been accentuated by national events deserves to be considered in weighing the question of whether some form of special, temporary stabilizing role for the Federal government is appropriate in order to bridge the time gap until the effects of meaningful fiscal reform can materialize.

In stressing that national problems have played a role in accentuating New York City's difficulties, we are not unmindful of the adverse impact of national recession and national inflation on other municipalities. The question of why New York City has been relatively more vulnerable to certain national problems -- especially to the problem of recession -- than other cities is extremely complicated. Part of the answer, though, clearly lies in the unique character of the huge migrations, both in and out of the City, that have occurred in the postwar period -- migrations that, in themselves, are exceedingly complex phenomena whose causes are not entirely of New York's making.

As you are well aware, the present problem of financial stress in New York -- tracing back to the default of New York State's Urban Development Corporation last February -- is no longer, unfortunately,

confined to the City. Despite a comparatively favorable budget record -- and a good prospect for decided budget improvement if general economic recovery continues -- New York State has seen its own credit-worthiness questioned in the markets. The rescue efforts of New York State on behalf of the City have impaired its standing in investors' eyes. The State's problems, moreover, have been greatly complicated by the fact that most of its agencies are not able to market debt at this time. We have now come to a point, in fact, where the securities of the entire State of New York, all its agencies, and many of its political sub-divisions -- not just New York City -- are for all practical purposes being boycotted by the national investment community. As indicated in an exhibit we are appending, the prospective borrowing needs between now and next June 30 of all the entities involved (the City, the State, and all State agencies and sub-divisions) appear to be upward of \$12 billion. There is simply no way that anything like that total of money can be raised without some degree of restoration of investor confidence.

It is important to realize that if default occurred -- followed by a suspension of all debt service payments -- it would be highly improbable that the ordinary business of the City could proceed at all normally. Indeed, both the City and the State need to have access to debt markets not just to cope with debt maturities and debt servicing, but to be able to avoid sudden and fundamental disruption in the provision of basic services. According to data compiled by the office of the New York City Comptroller, in New York City alone, the cash flow situation in the next three and a half months is so acute (as indicated in data appended to this statement), that even if the City could suspend all debt service payments -- both principal and interest -- it would still have a cash flow

short-fall in excess of \$1 billion. In other words, the City would be a full billion dollars short of being able to meet payments to its employees, its welfare recipients, and its suppliers. The consequences of an inability by the City to meet expenses of such magnitude (equivalent to one fourth of anticipated expenses excluding debt service during this period) could obviously be very severe.

The situation in the rest of the State -- posed by the fact that debt markets are basically closed down -- is also exceedingly worrisome in terms of potential disruption of services. If New York State cannot borrow the \$2½ billion in tax-anticipation funds that it would normally borrow next spring, that might well necessitate deferral of some considerable part of the aid flow to cities, towns, and school districts. In that event, serious adjustment problems would be inevitable widely throughout New York State -- in all its communities, including New York City.

What the consequences will be elsewhere in the country -- and indeed elsewhere in the world -- if the New York situation cannot be stabilized or quarantined is something we believe no one can be certain of. The fact that voices from abroad are beginning to express serious worry testifies to the potential reach of default.

We are mindful, of course, that this Committee has heard a range of judgments about the effects that might ensue from default. Our own conviction is that the potential consequences of any default are essentially unknowable before the event. This is particularly so because there are no meaningful precedents to guide an assessment, and also because psychological considerations could be of such dominant importance.

What is particularly disturbing in a quantitative sense is the possibility of a markedly adverse psychological reaction in the consumer and

business sectors of the economy. Were that to happen, an enormous downpull on general economic activity would be exerted. In the realm of State and local government matters, there clearly would be a distinct possibility of an intensification of the adversity that already has been experienced for a wide range of borrowers as a result of unease over the New York situation -- with the extreme danger being that some governmental units in addition to New York City, New York State, and New York State agencies would be unable to borrow on any terms at all. Incidentally, we would note that it is not precisely clear how much of the recent upward rate movement that has so far occurred in the tax-exempt securities market can be attributed to worry about New York. For the sake of balance, it is also worth mentioning in passing that by no means all State and local borrowers have suffered market adversity as a consequence of fall-out from the New York situation. Indeed, States and municipalities with exemplary financial records -- in areas particularly of the South, Southwest, and the West-- may even have gained relative benefit in the special quest investors are now making for high quality securities.

    Making an unconditional judgment about the full scope and severity of the repercussions that might flow from default is simply impossible, Mr. Chairman, as you yourself noted in your opening statement on October 8. Repercussions might be seriously troublesome to the national economy. Or, they might be much more muted than the grimmer possibilities suggest. However, the fact that neither we nor anyone else can know with certainty what the outcome of default would be seems critically relevant to the matter of whether this Congress should take some action. No one of the three of us joining in this statement is disposed in principle to urge Federal government involvement in the affairs of a State or municipality. But, in

this instance, we find ourselves obliged to acknowledge that a Federal role is inescapable if default is to be avoided. If one must think in terms of rescue funds running to many billions of dollars to help restore investor confidence, there clearly are not many avenues open.

Should this Committee come to the judgment that Federal assistance is appropriate, we would urge a very careful structuring of any aid package. We are firmly convinced that any kind of loan program, loan-guaranty program, or insurance program that did nothing more than simply relieve the immediate cash-flow problems of a troubled local or State government could be highly counterproductive over the longer term -- counterproductive in the sense of pushing today's problem into the future, only on a larger scale.

Experience demonstrates very emphatically that we need to tighten, not loosen, safeguards against undisciplined use of public funds. Simply making funds more readily available to a troubled governmental body would be a pointless step. In this regard, we are encouraged that the various proposals that have come before this Committee for creating a Federal mechanism for aiding troubled governmental units generally recognize in an explicit way the dangers that would be inherent in simply making it easier for funds to be secured.

The basic purpose of Federal assistance would be to afford time for a troubled governmental unit to restore its credibility in the marketplace. The specific form of such assistance -- whether direct loan, loan guarantee, or insurance -- seems less important to us than the criteria that ought to guide any assistance effort. These basically are:

(1) that stringent budgetary and repayment conditions be attached to the assistance;

- (2) that assistance be for the shortest time span feasible;
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- (5) that applicable interest rates on any Federal loan or service charges on any guaranteed or insured loan be sufficiently unattractive to the borrower to discourage recourse to such assistance except under conditions of extremity;
- (6) that Federal assistance be extended only at the State level and only after a State has effective machinery in place for controlling the use of funds by a local governmental unit;
- (7) that no new Federal bureaucracy be created to oversee or administer an aid program; and
- (8) that any State or State agency obligation guaranteed or insured under an assistance program be fully taxable.

Such terms are not meant to be punitive. They are essential, rather, to minimizing the risk that the Federal government could experience a loss as a result of extending temporary, emergency credit. They also are essential to maximizing the chance that assistance would really facilitate early reopening of normal debt-marketing channels. We would especially emphasize that some substantial portion of any sum lent, guaranteed, or insured be made available only for a limited term, say, up to one year, with renewal dependent on responsible self-discipline by

the user of the funds. For both safeguard and leverage purposes, specific provision should be made for tapping the stream of revenue-sharing funds flowing to a borrowing State in the event that a loan (whether made directly, guaranteed, or insured) was not repaid at maturity. The basic enabling legislation presumably would have to provide for use of the assistance by any one of the fifty States. As a practical matter, however, with strict criteria of the kind we contemplate, New York should be the only applicant.

Mr. Chairman, that essentially completes our prepared statement. In closing, we would make just one further point -- namely, that there would clearly seem to be a number of important legislative issues pertaining to State and local government affairs beyond those that can now be dealt with in the present emergency situation. Previous witnesses in these hearings have offered widely differing interpretations as to why New York City has had difficulties much more severe than other municipalities. At issue are allegations of unfairness relating to the Federal formulas for both revenue sharing and welfare support. Also involved is the key matter of whether the Federal government ought not to assume a greater share -- and perhaps all -- of the nation's welfare-cost burden. These are things that would seem to deserve very high priority by this and other Committees of Congress.

Mr. Chairman, Members of the Committee, may we again express our appreciation for this opportunity to testify today.

NEW YORK CITY CASH SHORTFALL: OCTOBER 18, 1975 - January 30, 1976  
(In Millions of Dollars)

<u>PERIOD</u>	<u>10/18-10/31</u>	<u>11/1-11/28</u>	<u>11/29-12/26</u>	<u>12/27-1/30</u>
Cash out (including debt service)	433	1,134	1,441	2,151
Cash in	278	669	348	991
Net cash out	155	465	1,093	1,160
Debt service	0	289	472	1,039
Net cash out (excluding debt service)	155	176	621	121
Cumulative cash out	155	331	952	1,073

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ESTIMATED CASH NEEDS OF NEW YORK STATE, STATE AGENCIES AND NEW YORK CITY  
THROUGH JUNE 30, 1976  
(millions)

	ROLLOVER	NEW MONEY	<u>TOTAL CASH NEEDS</u>
New York State	\$ 648.5 (a)	\$3,448.0	<u>\$ 4,096.5</u>
New York City	3,253.2	1,000.0 (b)	4,253.2
New York State Housing Finance Agency	910.0	200.0	1,110.0
New York State Medical Care Facilities Finance Agency	52.0	41.5	93.5
New York State Dormitory Authority	211.0	206.0	417.0
New York State Environmental Facilities Corporation	21.0	-	21.0
New York State Job Development Authority	-	20.0	20.0
New York State Atomic & Space Development Authority	-	25.0	25.0
Battery Park	-	76.0	76.0
Project Finance Agency	230.0	-	230.0
Albany County South Mall	-	70.0	70.0
New York City Educational Construction Fund	-	8.0	8.0
Port Authority of New York and New Jersey	-	100.0	100.0
Power Authority	125.0	350.0	475.0
Regional Transportation Authorities	2.0	-	2.0
	<hr/>	<hr/>	<hr/>
	\$5,452.7	\$5,544.5 (c)	\$10,997.2 (d)

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- (a) Includes \$611 million estimated deficit, for which an equal amount of outstanding TAN's will be rolled over.
- (b) Represents pro rata share of deficit and capital expenditures.
- (c) Estimates received from the New York State Budget Office and the New York City Comptroller's Office. It is possible that the new money requirements could shrink by as much as \$750 million by delaying or stopping currently programmed efforts.
- (d) The borrowing needs of other State municipalities are believed to be at least an additional \$2.0 billion making the total approximately \$13 billion.

October 16, 1975

The CHAIRMAN. All right. Mr. Clausen.

Mr. CLAUSEN. Mr. Chairman, I have submitted a written statement of Bank of America's views in the matter of New York's financial difficulties. Let me summarize:

There has been a considerable expenditure of effort and resources in recent months to comprehend and deal with the financial problems of New York City. While the involvement of the New York banks, investment dealers, and other city financial institutions is certainly evident, the fact that this selfsame concern is shared by institutions and governments outside New York has been virtually unacknowledged.

It should not remain unacknowledged.

Major urban centers outside New York resemble the city in a number of important ways. Their revenue structures are remarkably similar, considering the reliance on business-sensitive taxes, economic growth, and Federal and State aid. Other cities have increased public services, support payments, and subsidies, and substantially enlarged their role in the health-care, utility, education, and business-development areas.

There are differences of degree and magnitude, but in large cities across the Nation, the substance of the fiscal explosive is remarkably like that of New York City. The fuse in some cities is already alight; New York has provided the warning.

The object lesson of New York City should be an obvious and clear signal to other municipalities and governments, not to spend beyond their taxpayers' means by promising and providing services without adequate revenues to cover the costs.

The budget of New York City has consistently been among the highest in the Nation, reflecting both the size of the city and the scope of its public services. In recent years, New York has oriented its revenue structure more toward business-sensitive taxes than to its realty base, in order that economic gains in the form of increased sales, income, and the like could be more readily translated into the city's revenue stream.

In boom economic periods like the sixties, this process is insidiously self-feeding. Revenues rise sharply. In New York, the increase in revenue stimulated corresponding demands to spend—spend for better facilities, spend for higher salaries, spend for excessive administrative costs, spend for social-service programs.

This spending surge was nurtured as well by the Federal Government, whose matching support funds for water, sewer, highway, and other construction projects lured cities into the grantsmanship trap. The result, in sum, was the too-frequent generation of marginal or frivolous projects, and a greater than prudent dependence upon Federal aid.

In the seventies, city of New York revenue projections went sharply awry, as the recession impacted heavily on city tax returns. Instead of reducing services or cutting expenditures, the city elected to borrow to cover its revenue shortfall. The belief was that the budget, in any event, would be rationalized in due course.

It was, of course, poor reasoning. The city of New York's deficits and borrowing requirements increased sharply. The twin woes of inflation and recession combined to increase the costs of government, thwart commercial activity, and reduce budgetary avails from business-sensitive taxes. The city had to borrow regularly and massively in

the municipal note market. In the spring of 1975, the municipal note and bond markets closed to New York City.

In June, a new State agency, "Big MAC," was formed.

Big MAC bonds, however, found negligible support outside New York. Once more, the city's financial institutions had to absorb New York securities to sustain city operations.

It was hoped, again to no avail, that the establishment of the Emergency Financial Control Board, in conjunction with the most recent \$2.3 billion assistance plan, would help restore investor confidence.

But time has simply run out on New York City.

The State of New York can do no more. Not only has the State itself lost market access, but its creditworthiness, too, is in jeopardy.

The banks, for their part, are surfeited with city debt. The banks have done their share, and can do no more.

Without support, then, of the State and the banks, what is left for the city of New York? Default. But default, clearly, is an unacceptable alternative, in view of its financial and economic consequences for the city, the State of New York, and our Nation.

The incidence of default by States and their localities has been exceedingly rare in the postwar era. Accordingly, the prospect of default only narrowly entered the calculus of most municipal buyers in purchasing bonds for investment. However, the prospective default of New York City has already almost entirely closed the market to other government units in the State, regardless of their credit quality.

Beyond the State of New York, the market for municipal bonds has been severely affected, with interest rates reading at their highest point in history. As a result of what is happening in New York City, investor concern with quality has increased the borrowing costs of most other urban centers to the point of prohibition. In light of the major economic role of our State and local governments, the income and employment effects are correspondingly significant. I would call attention to the fact that State and local governments account for one out of every five jobs and 14 percent of the Nation's gross national product.

Some would seriously contend that a default by New York City would "clear the air"—that the consequences, however dire, would only be temporary. In my opinion, this is nonsense.

The effects of a New York City default may well be grave and enduring, not only in terms of our economy and financial markets, but also in terms of public confidence in government, and loss of international prestige.

In my judgment, the necessity of Federal support for New York City is neither optional nor debatable. Default certainly must be averted in the national interest. What remains to be resolved is the form that such Federal support should take.

At Bank of America, we believe that the most practical and effective means of aid would be the creation of a new Federal agency for the purpose of serving municipalities as a lender of last resort.

Such an agency could provide support not only for New York, but would also help alleviate part of the specter that now hangs over the Nation's municipal market.

In the written material I have presented, I have covered some of the safeguards we believe necessary for the functioning of such an

agency: safeguards to insure that the agency is indeed one of last resort; safeguards to discourage the idea that an agency loan is a pleasant solution; safeguards to insure that loans have minimum practical maturities; safeguards that include the stigma of surrender of fiscal and budgetary powers for any city seeking such aid; a tight set of controls and reports, and strong teeth to make certain that remedial measures will be taken by the municipality to relieve itself of deficit status and achieve currency of operations.

The first loan—and, we must hope, the only loan—of such a Federal municipal agency, should it be created, would necessarily be for benefit of the city of New York. This loan should be sufficient to cover the full amount of the city's accumulated deficit, as well as the projected shortfall for fiscal 1976.

In addition to averting default, the purpose of this loan would be to give New York City ample opportunity to demonstrate both the willingness and ability to live within its means. Assuming, as we must, that this result is possible, investor confidence should be restored to the point where New York City may regain market access within 2 years, and be established once more as a premier city of our Nation and the world.

Thank you.

[Complete statement of Mr. Clausen follows:]

STATEMENT OF A. W. CLAUSEN, PRESIDENT  
BANKAMERICA CORPORATION, SAN FRANCISCO, CALIFORNIA  
BEFORE THE SENATE COMMITTEE ON BANKING, HOUSING  
AND URBAN AFFAIRS ON OCTOBER 18, 1975

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There has been a considerable expenditure of effort and resources in recent months to comprehend and deal with the budgetary problems of New York City. While the involvement of the New York banks, investment dealers and other city financial institutions is certainly evident, the fact that this selfsame concern is shared by institutions and governments outside of New York has been virtually unacknowledged. It is widely reported, to the contrary, that rather than being an event of interest or sympathy, the plight of New York is an occasion of "perverse glee" for many other of our country's cities and institutions. The perverseness, however, lies essentially in the reporting, because no responsible governmental leader could fail to identify with the root problems of New York, nor has any institution outside of the city been immune to or insulated from the impact of New York's difficulties on the financial markets of our nation and the world.

The City of New York has a massive operating deficit. More onerous, in terms of accommodation and magnitudes, is the city's accumulated or "floating" deficit of prior years. The fault for these imbalances lies partly in mismanagement. Although mismanagement of itself should scarcely be condoned, this element of difficulty is inextricably related to the self-concept of New York and its basic revenue structure. New York has taken considerable pride over the years in its national role as the city of opportunity. Whether in finance, commerce, education, culture, or the arts, New York has traditionally sought to sustain a position of leadership. In keeping also with its opportunity concept, New York assumed an ever increasing and more costly role in providing welfare, housing, health-care, and other life-support services to the disadvantaged as well as financial aid or comparable incentives for business development and expansion.

The budget of New York City has consistently been among the highest in the nation, reflecting both the size of the city and the scope of its public services. Similar to other progressive cities in recent years, New York has oriented its revenue structure more towards business-sensitive taxes than to its realty base, such that economic gains in the form of increased sales, income, and the like could be more readily translated into the city's revenue stream. This process, in boom economic periods like the sixties, is insidiously self-feeding. Revenues rise sharply and consistently. In New York, the increase in revenue availability stimulated corresponding demands to spend, for better facilities, higher salaries, and larger subsidies for social-service programs. This spending surge was nurtured as well by the Federal government, whose matching support funds for water, sewer, highway, and numerous other construction projects and programs lured cities into the grantsmanship trap. The result, in sum, was the too-frequent generation of marginal or simply frivolous projects and a greater budgetary dependence on Federal aid.

The turn of the seventies marked a change for the worse in the economic fortunes of our nation and no less for the City of New York. Revenue projections went sharply awry, as the unexpected slackening in income and sales growth rates impacted heavily on city tax returns. Instead of reducing services or cutting expenditures, the city elected to borrow to cover its revenue shortfall. The belief was that the budget in any event would be rationalized in due course, under the consensus assumption that the economic downturn would be short-lived and that better coordination would be attained in timing Federal and state aid payments with the city's expenditure schedules.

Only the City of New York did not share in the nation's modest economic recovery of the early seventies. Both its deficits and borrowing requirements increased sharply during this period, in part to meet the growing demands of the city's social-service programs but also to foster new construction, employment, and income gains. These efforts, of course, proved futile, as the twin woes of inflation and recession in 1974-75 combined on the one hand to increase the costs of government, thwart commercial activity, and at the same time reduce budgetary avails from business-sensitive sources. In order to maintain operations, the city had to borrow regularly and massively in the municipal note market to roll over maturing obligations and also to cover prevailing and prospective deficits. Seeing little evidence for the foreseeable future that the situation would change, together with the virtual disappearance of individual and institutional interest in New York paper, the municipal note and bond markets closed to New York City in the Spring of 1975. The debt supply, simply, was too great, but it was the loss of investor confidence that at last proved insurmountable.

Major urban centers outside of New York resemble the city in a number of important respects. Their revenue structures, for example, are remarkably similar, considering the reliance on business-sensitive taxes, economic growth, and Federal and state aid. The demand as well in other parts of the country for increased public services, support payments, and subsidies has substantially enlarged the role of cities in the health-care, utility, education, and business development areas. While the proportion of such involvement does not yet in most cases match that of New York, the trend is clear and well-established. And no city, regardless of location, is invulnerable to public-employee unions and pension-fund requirements. Consider, too, that New York City is the urban laboratory of the nation. A significant percentage of the principal advances in city utility services, police and firefighting technology, building design, transportation, public instruction and finance were pioneered and tested in New York. Many of these advances were incorporated into the programs of other cities throughout the country. But now, there has been an explosion in the urban laboratory. Does any city dare to laugh? On what basis? There are differences, certainly, of degree and magnitude, but the substance of the explosive is remarkably like New York's in large cities across the nation. The fuse in some cities is already alight. And once more New York has provided the warning.

The loss of market access by the City of New York was compensated for between April and June largely by cash advances, loans, and security purchases by the State of New York and financial institutions in the city, as well as through accelerated revenue sharing and other aid payments from the Federal government. The major effort by the state, city banks, and investment dealer to broaden the source of funds to the city took the form in June of a new state agency which was authorized to issue up to \$3 billion in debt in behalf of the city. Debt service payments of the agency, called the Municipal Assistance Corporation or "Big MAC", would be secured by city sales and stock transfer taxes coupled with a state back-up provision which would enable the state to cover any shortfall to meet principal or interest requirements. It was assumed, given the strength of the debt security and the state back-up, that "Big MAC" bonds would be attractive to national investors. The \$3 billion in new funds, moreover would be sufficient to carry the city through December, with the intervening period to be used by the city in streamlining its operating and budgetary procedures such that investor confidence and market access would be restored in January 1976.

The plan never worked. "Big MAC" bonds, which were publicly offered in two series in July and August, found negligible support outside of New York. Investors, although knowing better, chose not to dissociate the credit of "Big MAC" from the city's own credit, which made the bonds unsalable at any price. Once more, therefore, the city's financial institutions and other large city-based corporations had to absorb New York securities to sustain city operations. In fact, from mid-August to date, it has only been through the issuance of notes by the State of New York, the purchase of "Big MAC" paper by certain New York banks and city and state pension funds, and the rollover of maturing city notes by these banks that default by New York City has been averted. It was hoped, again to no avail, that the establishment of the Emergency Financial Control Board in conjunction with the most recent \$2.3 billion rescue plan would help restore investor confidence, but time and the courts have simply run out on New York City. The State of New York can do no more. Not only has the state itself lost market access, but its credit-worthiness too is in jeopardy. Moody's Investor Service has just lowered the bond rating of New York State from "Aa" to "A-1" and has either reduced or dropped the bond and note ratings of a number of state agencies. The banks, for their part, are surfeited with city debt, to the point where their own stock prices and market standing may become vulnerable. Now that Moody's too, in downgrading the city's bonds to "Ba", has joined Standard & Poor in removing all city debt from investment-grade status, the bank examiners are calling New York security holdings even more seriously into question. The banks, quite clearly, have done their share and can do no more. Without the support, then, of the state and the banks, what is left for the City of New York. Default. But default, just as clearly, is an unacceptable alternative, in view fully of its financial and economic consequences for the city, the State of New York, and our nation.

The financial markets of the country are **floundering**, owing in considerable part to New York City's budgetary difficulties. The market for municipal bonds has been the most severely affected, with interest rates currently at their highest point in history. Yet the numbers alone only reflect part of the dilemma. Investor concern with quality as a result of New York City has increased sharply from the norm the borrowing costs of most other urban centers, as well as of medium-grade credits generally. Considering that the bulk of municipal credits are in the medium-grade category, the prohibitive cost of borrowing has forced the cancelation or delay of numerous housing and public works projects. In light further of the major economic role of our state and local governments, the income and employment effects of their lagging economic participation are correspondingly significant.

The incidence of default by states and their localities has been exceedingly rare in the postwar era. Accordingly, the prospect of default only narrowly enters the calculus of most municipal buyers in purchasing bonds for investment. Observe, however, that the prospective default of New York City has even now almost entirely closed the market to other governmental units in the state regardless of their credit quality. A default in fact by the city would likely lock out New York borrowers totally from the national debt markets. In addition, the shock of default to municipal buyers could well limit their purchases indefinitely to prime-grade bonds only. The civic and economic consequences of such a decision would obviously be enormous for states and localities throughout the nation.

It has been said seriously indeed, that a default by New York City would "clear the air". The consequences, however dire, would only be temporary. Financial markets, in time, would recover, as would the banks, nonfinancial corporations and individuals which hold defaulted debt or whose present business viability is dependent in turn on the solvency of New York City. The lawsuits, too, which would multiply by the score and freeze the machinery of city government, would be settled also in due course without lasting civic impairment. Foreign governments, to which a default by New York still is inconceivable, would come also to understand how our Federal government could allow the disgrace of default by the nation's largest city and its foremost commercial and financial center.

Reasoning of this kind has led to a certain adamance by Administration officials on the subject of Federal intervention in behalf of New York City. It is held, furthermore, that only if New York is permitted to default will the experience serve fully as an object lesson for other, similarly profligate cities. Both the reasoning and this conclusion are patently false. The effects of a New York City default **may well** be grave and enduring, not only in terms of our economy and financial markets, but also of public confidence in government and loss of international prestige. Secondly, in the course of developing the various rescue plans for New York,

the city has been compelled to surrender to the state, "Big MAC", or the Emergency Financial Control Board almost all financial and budgetary control of its affairs. This surrender of itself should be a sufficient object lesson for profligate municipalities, without grinding New York City into default.

It should be clear at this point that the necessity of Federal support for New York City is neither optional nor debatable. Default most certainly must be averted in the national interest. What remains only to be resolved is the form that such Federal support should take. Bank of America recommends accordingly, that: 1) a new agency should be created in the Federal government for the purpose of serving municipalities as a lender of last resort; 2) eligibility for aid through this agency would require that the applicant municipality have been denied market access irreversibly, and have exhausted all other sources of support from superior governments and financial institutions; 3) a municipality receiving aid from the agency would have to convey all of its fiscal and budgetary powers to the state until two years after the aid is repaid; 4) aid from the agency should be disbursed only as loans whose final maturity must be set to the closest date that the loans can reasonably be repaid; 5) loan funds of the agency should be supplied by the Federal Financing Bank for relending to municipalities at 1/2 of 1% above the then prevailing rate of other bank loans to Federal agencies; 6) the state in which an agency-benefited municipality is contained should be required to demonstrate annually to the agency during the life of the loan what remedial measures have been taken by the municipality to relieve its deficit status and achieve currency of operations; 7) loans by the agency which remain unpaid in whole or part at maturity should become a first claim on Federal revenue-sharing monies of the municipality; 8) loans should be subject to immediate call by the agency in the event that a state fails to comply with agency report requirements, or that the benefited municipality is unable to demonstrate sufficient progress in rationalizing its financial position; 9) the governing board of the Federal Municipal Loan Agency should be chaired by the Secretary of the Treasury and additionally consist of the Secretaries of H. U. D. and H. E. W. as well as two public members representing local governments and the municipal bond industry.

The first loan of the Federal Municipal Loan Agency will necessarily **for** the City of New York. This loan should be sufficient to cover the full amount of the city's accumulated deficit as well as the projected shortfall for fiscal 1976. Terms of the loan are negotiable, but the final maturity should probably not exceed ten years with first principal due in the seventh year. In addition to averting default, the purpose of this loan is to give New York City ample opportunity to demonstrate both the willingness and ability to live within its means. Assuming as we must that this result is possible, investor confidence should be restored to the point where New York City may regain market access in fiscal 1977 and be established once more as a premier city of our nation and the world.

ADDENDUM  
GUARANTEES OR LOANS

Bank of America believes that Federal assistance to New York should be provided in the form of a loan rather than through a guarantee or insurance program. Our reasons in support of this position are principally as follows:

- 1) The costs to the Federal government in the event of a city default would be substantially less under the loan mechanism than the guarantee. Funds to provide the loan to the city will be borrowed by the Federal Municipal Loan Agency from the Federal Financing Bank. FFB funds, in turn, are obtained by the U.S. Treasury from the proceeds of its own borrowing. If these funds were to be raised either through the issuance of taxable, Federally-guaranteed securities by the city or the Federal Municipal Loan Agency, the interest rate on such securities would be considerably higher than the rate on direct U.S. obligations. As a result, the cost to the Treasury of redeeming defaulted securities would be correspondingly greater than its cost of borrowing funds for the loan.
- 2) The use of a Federal guarantee in association with tax-exempt securities issued by the city or the FMLA, would create a debt instrument superior to U.S. Treasury obligations in the sense that the debt would not only have Federal backing, but also that the interest on such debt would be exempt as well from Federal taxation. Considering further the present market disinclination towards New York securities, it can reasonably be assumed that less than the full benefit of a Federal guarantee would accrue to the city by way of lower interest costs on its borrowing. The principal beneficiary, therefore, of a tax-exempt, Federally-guaranteed city debt instrument would be the investor ... which is scarcely the point of the program.
- 3) A Federal guarantee, in support of either a tax-exempt or taxable public borrowing, also fails the test of equity. New York City, in effect, would be gaining a preferred status for its securities, which could not be denied in fairness to other cities in difficulty. While the loan mechanism too is a "preferred" form of borrowing, the onus of repaying a loan is considerably stronger and more direct than meeting debt-service payments to an investor which are additionally secured by the Federal government. It is less likely, from this standpoint, that other local governments would apply as readily for Federal assistance if the aid were in loan form than as a Federal guarantee.
- 4) A key provision of the loan agreement between the FMLA and the city, is that the loan is callable immediately if either the city or the state is in violation of the loan terms. A guarantee, on the other hand, cannot be rescinded, because of the Federal government's obligation to the owner of the guaranteed securities who purchased them in good faith. By using the loan method, therefore, the Federal government will be better able to enforce fiscal discipline and control on the state and city, which could be lost through the guarantee approach.

- 5) The provision of funds to New York City in any form will involve the issuance of debt. If the loan form is chosen, the funds would be raised in the Government securities market by the U.S. Treasury for use of the Federal Financing Bank. In the case of guaranteed securities, the funds for taxable debt would be provided through the Federal agency market or, for exempt debt, in the municipal bond market. Owing to the fact that the market for Government securities is the broadest and most efficient, the impact on capital markets generally would be least if the loan method were used.

The CHAIRMAN. Thank you very much, Mr. Clausen.

Mr. Crawford, I understand you have a statement which will speak for yourself, Mr. Rauch and Mr. Albright and Mr. Rauch has a short statement.

Mr. CRAWFORD. Mr. Chairman, I am Morris D. Crawford, Jr., chairman of the board of The Bowery Savings Bank in New York City.

I am accompanied by Mr. Stewart Rauch, Jr., chairman of the Philadelphia Saving Fund Society, in Philadelphia; and Harry W. Albright, Jr., President of The Dime Savings Bank of New York in New York City.

These gentlemen join in this statement, but would like, with your permission, to make a brief statement of their own.

The CHAIRMAN. All right.

Mr. CRAWFORD. We represent the three largest savings banks in the United States. This joint statement is also endorsed by the chairman or president of the seven next largest savings banks, listed at the end of our written statement. We speak for ourselves, not for our trade associations.

We believe:

1. That unless the Federal Government acts to aid the city, either directly or through the State, a default by the city on its debt is inevitable;

2. That the consequences of default cannot be accurately foretold by anyone, but the risks, not only to the financial markets but to the economy and to the social fabric of this country are unacceptable;

3. That the city should be sustained by temporary Federal aid while progress is being made by those who are dealing directly with the city's budgetary problems. This will give Congress opportunity to consider in depth, and not in a crisis atmosphere, the extent to which, in the light of extraordinary social and economic change in the country, the Federal Government should provide further financial support to our cities.

It is not our purpose to point the finger of blame at the city, State or Federal Government, the business or financial communities, or the public service unions. There is ample blame to spread about. The question as to how the problem arose is for the political scientists and the historians. The important question today is how to solve the problem at the least social and economic cost.

No one is able to predict with confidence the consequences of a default. Already, not only the city but also the State finds access to the public markets is denied them. Governors of States as distant as Colorado and South Dakota note the precipitous increase in interest rates required to be paid on their State and municipal obligations.

The Chancellor of West Germany has expressed concern about the ripple effects of a New York default on European financial institutions.

The chief fiscal officer of Philadelphia has told this committee that his city and others might be "out of business" in a short time if New York City defaults. The business council, composed of the Nation's top 100 corporate executives, while troubled about the principle of Federal aid, nevertheless favored Federal action, because default would undermine public confidence and might abort the economic recovery just now getting underway.

We need not repeat the many other expressions of deep concern by the distinguished witnesses appearing before this committee in recent days.

Further interruption in the flow of funds, goods or services in New York City could cripple our already reduced services. In the background looms the possibility of a general strike that might bring a most unwelcome Federal or State presence into the city, with obvious potential for ugly confrontations and civil disorders.

The real question is whether it is necessary to invite the risk of any of these occurrences. We believe all possible efforts should be directed toward avoidance of such risk.

New York remains the greatest and most productive metropolis in the world. Like many others, it is deeply troubled, partly because of its own inefficiencies, partly because of the enormity of the social and economic problems with which it must deal, but which it did not create. Its deliverance lies in a combination of its own efforts and those of the Federal and State governments.

New York City bears the responsibility for correcting the fiscal errors of recent years. We must act to assure that the Nation's largest city operates within a budget that is balanced in accordance with proper accounting principles. And we have already moved far in this direction. Establishment of the Emergency Financial Control Board and the mandates it has placed on the city for tough corrective action are precisely the kind of steps that are needed.

But even as we act to assure that New York City cannot again base its budget on hopes and promises, it is essential that sound principles of fiscal equity also be observed. New York City must not be made responsible for fiscal burdens beyond its capacity. I refer specifically to the rapidly growing costs of social services and medical care for the poor.

New York City is nearly unique among the major cities of the Nation in being forced to bear the local share of the cost of what is elsewhere a State or county function. Neither Chicago or Philadelphia nor Los Angeles, to name only a few of our major cities, must bear the burden of public assistance within its municipal budget. These costs account for over a quarter of New York City's budget.

We are convinced that if New York City is relieved of the disproportionate welfare and other poverty-related costs that simply cannot be supported out of a municipal revenue base, the city's current fiscal problems would be far more readily manageable.

We call upon the Congress for action that will meet both the immediate fiscal crisis and the longer-run financial problems of the Nation's cities. Specifically, we suggest the following regarding the crisis in New York City:

1. Federal action to provide temporary support to stave off a potentially disastrous default by the city or the State;
2. Continuing State action to assure that the city lives within its means; and
3. State and Federal action to relieve the city of the inappropriate burden of welfare and other poverty related costs.

The efforts of the Emergency Financial Control Board will hopefully sustain New York City under December 1. Thereafter, default looms again. Decisive temporary Federal supportive action should be taken before December 1.

We urge the Congress to then develop a plan to ameliorate and hopefully solve the longer-range fiscal problems of American cities.

Thank you very much, Mr. Chairman. If I might ask Mr. Rauch and Mr. Albright to be briefly heard.

Mr. Rauch is at the far end of the long table. I would like to ask Mr. Rauch to speak first and then Mr. Albright.

[Mr. Crawford's prepared statement follows:]

STATEMENT OF MORRIS D. CRAWFORD, JR., TO THE SENATE  
 COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS ON  
 FEDERAL AID TO NEW YORK CITY, WASHINGTON, D. C.,  
 OCTOBER 18, 1975.

I am Morris D. Crawford, Jr., Chairman of the Board of The Bovey Savings Bank, in New York City. I am accompanied by R. Stewart Rauch, Jr., Chairman of The Philadelphia Saving Fund Society, in Philadelphia; and Harry W. Albright, Jr., President of The Dime Savings Bank of New York, in New York City. These gentlemen join in this statement. Mr. Rauch would like to make a brief supplemental statement. We represent the three largest savings Banks in the United States. This joint statement is also endorsed by the Chairman or President of the seven next largest savings banks--listed at the end of our written statement. We speak for ourselves, not for our trade associations.

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1. that unless the Federal Government acts to aid the City, either directly or through the State, a default by the City on its debt is inevitable;
2. that the consequences of default cannot be accurately foretold by anyone, but the risks, not only to the financial markets but to the economy and to the social fabric of this country, are unacceptable;
3. that the City should be sustained by temporary

Federal aid while progress is being made by those who are dealing directly with the City's budgetary problems. This will give Congress opportunity to consider in depth (and not in a crisis atmosphere) the extent to which, in the light of extraordinary social and economic change in the country, the Federal Government should provide further financial support to our cities.

It is not our purpose to point the finger of blame at the City, State, or Federal Government, the business or financial communities, or the public service unions. There is ample blame to spread about. The question as to how the problem arose is for the political scientists and the historians. The important question today is how to solve the problem at the least social and economic cost.

No one is able to predict with confidence the consequences of a default. Already, not only the City but also the State finds access to the public markets is denied them. Governors of states as distant as Colorado and South Dakota note the precipitous increase in interest rates required to be paid on their state and municipal obligations. The Chancellor of West Germany has expressed concern about the ripple effects of a New York default on European financial institutions. The chief fiscal officer of Philadelphia has told this Committee that his City and others might be "out of business" in a short time if New York City defaults. The Business Council--composed of the Nation's top 100 corporate

executives--while troubled about the principle of Federal aid--nevertheless favored Federal action because default would undermine public confidence and might abort the economic recovery just now getting under way. We need not repeat the many other expressions of deep concern by the distinguished witnesses appearing before this Committee in recent days.

Further interruption in the flow of funds, goods or services in New York City could cripple our already reduced services. In the background looms the possibility of a general strike that might bring a most unwelcome Federal presence into the City, with obvious potential for ugly confrontations and civil disorders.

The real question is whether it is necessary to invite the risk of any of these occurrences. We believe all possible efforts should be directed toward avoidance of such risk.

New York City remains the greatest and most productive metropolis in the world. Like many others, it is deeply troubled--partly because of its own inefficiencies, partly because of the enormity of the social and economic problems with which it must deal but which it did not create. Its deliverance lies in a combination of its own efforts and those of the Federal and State governments.

New York City bears the responsibility for correcting the fiscal errors of recent years. We must act to assure that

the Nation's largest city operates within a budget that is balanced in accordance with proper accounting principles. And we have already moved far in this direction. Establishment of the Emergency Financial Control Board and the mandates it has placed on the City for tough corrective action are precisely the kind of steps that are needed.

But even as we act to assure that New York City cannot again base its budget on hopes and promises, it is essential that sound principles of fiscal equity also be observed. New York City must not be made responsible for fiscal burdens beyond its capacity. I refer specifically to the rapidly growing costs of financial assistance and medical care for the poor.

New York City is nearly unique among the major cities of the Nation in being forced to bear the local share of the cost of what is elsewhere a state or county function. Neither Chicago nor Philadelphia nor Los Angeles--to name only a few of our major cities--must bear the burden of public assistance within its municipal budget. These costs account for over a quarter of New York City's budget.

We are convinced that if New York City is relieved of the disproportionate welfare and other poverty-related costs that simply cannot be supported out of a municipal revenue base, the City's current fiscal problems would be far more readily manageable.

We call upon the Congress for action that will meet both the immediate fiscal crisis and the longer-run financial problems of the Nation's cities. Specifically, we suggest the following regarding the crisis in New York City:

1. Federal action to provide temporary support to stave off a potentially disastrous default by the City or the State.
2. Continuing State action to assure that the City lives within its means.
3. State and Federal action to relieve the City of the inappropriate burden of welfare and other poverty-related costs.

The efforts of the Emergency Financial Control Board will hopefully sustain New York City until December 1. Thereafter, default looms again. Decisive temporary Federal supportive action should be taken before December 1. We urge the Congress to then develop a plan to ameliorate, and hopefully solve, the longer-range fiscal problems of American cities.

Seven Next Largest Savings Banks

1. The New York Bank for Savings (Alfred S. Mills, Chairman)
2. Dollar Savings Bank of New York (Henry G. Waltemade, Chairman)
3. Emigrant Savings Bank (Joseph C. Brennan, Chairman)
4. The Greenwich Savings Bank (William S. Brennen, Chairman)
5. The Williamsburgh Savings Bank (Joseph A. Kaiser, Chairman)
6. The Lincoln Savings Bank (Covington Hardee, Chairman)
7. Buffalo Savings Bank (Robert W. Ramsey, President)

The CHAIRMAN. All right, Mr. Rauch, go right ahead.

Mr. RAUCH. Thank you, Mr. Chairman. I appreciate this opportunity to supplement the statement presented by Mr. Crawford.

The Philadelphia Saving Fund Society's portfolio is oriented toward housing investment, and happens to have little direct exposure to loss because of possible default on New York or other State and municipal bonds. But simply adding up New York securities in bank portfolios and relating the totals to capital funds, as the supervisory agencies have done, is an inadequate measure of the potential costs of New York's financial crisis. Our concern is with the viability of institutions and the strength of the economy as they may be affected by a demoralized securities market, not merely with capital writeoffs, disruptive though these may be in themselves.

A little over a week ago, the Philadelphia Hospital Authority was forced to pay an effective interest rate of over 9.8 percent, tax free, for building funds—over 100 basis points higher than it paid 2 months ago for a similar project. Thomas Jefferson University Hospital will be burdened with this cost—as will the community it serves—for many years. This experience probably represents the outer limit of financial feasibility for public construction. A protracted crisis brought on by default in New York can delay the development of community facilities and slow the recovery of housing and capital investment in many sectors of the economy.

New York's problem cannot be kept within the boundaries of that city and State. In the long run it will require reforms and adjustments which are national in scope. In the short run it requires prompt and specific interim guarantees.

Thank you very much.

The CHAIRMAN. Thank you, Mr. Rauch.

Mr. ALBRIGHT?

Mr. ALBRIGHT. Mr. Chairman, I am grateful for this opportunity to express my views from my perspective, principally derived from my recent experience as bank regulator for New York for almost 3 years.

At the outset, I believe that the financial crisis in New York City and New York State is now recognized by people in communities all across the United States as far more significant, serious, and symbolic to their own lives than some of us might earlier have thought. I believe that the people of this country have a sense that the problems of New York are symptomatic of broader national problems, and that we are at a very important crossroads. We can either go the way of Great Britain or, if we have the will, we can straighten out our fiscal situation and preserve intact the benefits of free markets as well as our Federal system of Government.

The underlying question that faces all of us is really whether a democratic society can, in fact, impose upon itself the kinds of stringent disciplines that are so clearly necessary.

The problems New York is encountering are not limited to New York, and the disciplines that must be applied in New York City are the very disciplines that must sooner or later be applied to the Federal budget.

I genuinely believe that the constructive efforts of the State of New York and the city to deal with the present situation are becoming more fully appreciated.

While the inability of the city to sell its securities has forced the city to take measures which otherwise would not have been taken, it is surely apparent by now that genuine reform is being accomplished. For example, since June the following steps have been taken :

Creation by the State of the Municipal Assistance Corporation and its issue of more than \$2 billion in securities ;

Creation by the city of an independent management review board under the direction of the chairman of the Metropolitan Life Insurance Co.

Creation of a financial review committee under Judge Owen McGovern ;

Creation of the Emergency Financial Control Board, under the chairmanship of the Governor, with full budgetary power over the city ;

Appointment of the chief financial officer of J. C. Penney as special deputy mayor for financial and budgetary affairs ;

A wage freeze on all city employees ;

Commitment by the State of \$750 million and corresponding financial commitments by all segments of the financial community, pursuant to which by December combined State and local private resources provided to the city since June will total more than \$4 billion.

It is particularly important that the Emergency Financial Control Board is expressly empowered to determine city revenue estimates and to force expenditures to a level within those estimates.

Many of these actions of the city and State are extremely painful and entail real human sacrifice and are not to be underestimated by those who are calling for the imposition of even greater tax burden upon the city and State. They will, however, if given a chance, lay the foundation for sound fiscal management in New York City.

But it is vitally important that these reforms be given a chance.

As a former regulator of New York banks, I am confident that the financial institutions of this country, and particularly those in New York State, with which I am most familiar, are strong and sound and are capable of withstanding or handling any of the difficult situations that face us, even including a possible default by New York City. In this regard, the Federal regulatory agencies, and in particular the Federal Reserve, have indicated their readiness to act quickly if needed to provide the necessary guarantees for a safe and sound banking system in the State and Nation.

But having said this, I must emphasize the extent of the psychological damage that a possible default, either by the State or by the city, could produce. New York City is the financial center of the world and is a major force in sustaining international commerce, necessary for the survival of an increasingly interdependent world. It is important not only to the people of the United States but indeed all the free world that nothing shake the confidence of our will to preserve those markets.

Really, what New York City needs is time to act.

One lesson I learned, when I had regulatory responsibilities, when at the time I was with Franklin National, when Franklin National encountered its difficulties and its market became contaminated, nothing in the short term could restore the confidence that had been lost. To meet the emergency, the Federal Reserve Board provided a strong

public statement of commitment, and backed that commitment by loaning better than \$1.8 billion to the Franklin. But the clear lesson that the Franklin experience taught me was that it took strong, decisive action by the Federal Government to provide the necessary time to permit through the intercession of the Chairman, Frank Wille of the FDIC, the merger of Franklin into the State-chartered European American Bank & Trust Co.

Thus today, it is my strong view that the city of New York is incapable, in the short term, of overcoming by itself the loss of investor confidence that has most disastrously affected not only the market for New York obligations but also the markets for municipal bonds and paper across the country. I am here today, therefore, to urge that the Federal Government act quickly and most importantly decisively to help restore the confidence of the public in the financial integrity of New York City and State obligations and of municipal obligations generally.

I am not asking for a Federal "bailout" of the city; I am asking for the means by which the city and State can implement the financial reforms now in place. Without immediate financial assistance, these reforms simply will not have a chance. That action would take a number of forms.

One form immediate assistance might take is for Congress to authorize the Treasury to buy a significant amount of State Agency bonds (in the case of New York, "Big Mac" bonds) supported by Federal revenue sharing due and owing to the State from the Federal Government.

In addition, consideration should be given to longer term solutions to the problem of municipal financing, such as co-insurance of municipal bonds or a Federal Deposit Insurance Corporation type fund to fully insure small investors.

Ultimately, I'm sure one must recognize that there is a real need for the assumption by the Federal Government of the welfare burden which continues to cause a wholly disproportionate and unfair tax burden to fall on New York and other cities of the country.

But it seems clear to me that both the administration and the Congress must address themselves to devising an affirmative program that will be sufficiently all-encompassing and decisive, in combination with the efforts of the city and State, to restore that very essential confidence.

There is a compelling need for, now and to avert a default and enable a genuine reform, now in place, to work.

Finally, I am optimistic because I believe that there is a clear perception by all of us that this country must impose upon itself the necessary sacrifices and disciplines to keep it strong and to preserve our democratic institutions and free markets.

Thank you.

[Complete statement of Mr. Albright follows:]

Supplemental Statement of Harry W. Albright, Jr.,  
to the Senate Committee on Banking, Housing and Urban Affairs  
on Federal Aid to New York City, Washington, D.C.,  
October 18, 1975

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I am Harry W. Albright, Jr., President of The Dime Savings Bank of New York, in New York City. I am most grateful for this opportunity to express my views on the financial problems of New York from a perspective principally derived from my recent experience as the Superintendent of Banks of New York State for almost three years.

At the outset, I believe that the financial crisis in New York City and New York State is now recognized by people in communities all across the United States as far more significant, serious and symbolic to their own lives than some of us might earlier have thought. I believe that the people of this country have a sense that the problems of New York are symptomatic of broader national problems, and that we are at a very important crossroads. We can either go the way of Great Britain or, if we have the will, we can straighten out our fiscal situation and preserve intact the benefits of free markets as well as our federal system of government.

The underlying question that faces all of us is really whether a democratic society can, in fact, impose upon itself the kinds of stringent disciplines that are so clearly necessary. The problems New York is encountering are not limited to New York, and the disciplines that must be applied in New York City are the very disciplines that must sooner or later be applied to the Federal budget.

I genuinely believe that the constructive efforts of the State of New York and the City to deal with the present situation are becoming more fully appreciated.

While the inability of the City to sell its securities has forced the City to take measures which otherwise would not have been taken, it is surely apparent by now that genuine reform is being accomplished. For example, since June the following steps have been taken:

- creation by the State of the Municipal Assistance Corporation and its issue of more than \$2 billion in securities;

- creation by the City of an independent Management Review Board under the direction of the Chairman of the Metropolitan Life Insurance Company;

- creation of a Financial Review Committee under Judge Owen McGivern;

- creation of the Emergency Financial Control Board, under the Chairmanship of the Governor, with full budgetary power over the City;

- appointment of the chief financial officer of J.C. Penney as Special Deputy Mayor for financial and budgetary affairs;

- a wage freeze on all City employees;

- commitment by the State of \$750 million and corresponding financial commitments by all segments of the financial community, pursuant to which by December combined State and local private resources provided to the City since June will total more than \$4 billion.

It is particularly important that the Emergency Financial Control Board is expressly empowered to determine City revenue estimates and to force expenditures to a level within those estimates.

Many of these actions of the City and State are painful and entail real human sacrifice and are not to be underestimated by those who are calling for the imposition of even greater tax burden upon the City and State. They will, however, if given a chance, lay the foundation for sound fiscal management in New York City.

But it is vitally important that these reforms be given a chance.

As a former regulator of New York Banks, I am confident that the financial institutions of this country, and particularly those in New York State, with which I am most familiar, are strong and sound and are capable of withstanding or handling any of the difficult situations that face us, even including a possible default by New York City. In this regard, the federal regulatory agencies, and in particular the Federal Reserve, have indicated their readiness to act quickly if need to provide the necessary guarantees for a safe and sound banking system in the state and nation.

But having said this, I must emphasize the extent of the psychological damage that a possible default, either by the State or by the City, could produce. New York City is the financial center of the world and is a major force in sustaining international commerce, necessary for the survival of an increasingly interdependent world. It is important not only to the people of the United States but indeed all the free world that nothing shake the confidence of our will to preserve those markets.

What New York City needs is time to act.

Let me cite, the lesson I learned as Superintendent of Banks in New York State at the time of the difficulties of the Franklin National. When the Franklin encountered its difficulties, and its market became contaminated, nothing in the short term could restore the confidence that had been lost. To meet the emergency, the Federal Reserve Board provided a strong public statement of commitment, and backed that commitment by loaning better than \$1.8 billion to the Franklin. But the clear lesson that the Franklin experience taught me was that it took strong, decisive action by the Federal Government to provide the necessary time to permit through the intercession of the Chairman, Frank Wille of the FDIC, the merger of Franklin into the State-chartered European American Bank and Trust Co.

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Ultimately, I'm sure one must recognize that, there is a real need for the assumption by the Federal government of the welfare burden which continues to cause a wholly disproportionate and unfair tax burden to fall on New York and other cities.

But it seems clear to me that both the Administration and the Congress must address themselves to devising an affirmative program that will be sufficiently all-encompassing and decisive, in combination with the efforts of the City and State, to restore that very essential confidence.

But most importantly, there is a compelling need for action now to avert a default and enable genuine reforms, now in place, to work.

Finally, I am optimistic because I believe that there is a clear perception by all of us that this country must impose upon itself the necessary sacrifices and disciplines to keep it strong and to preserve our democratic institutions and free markets.

The CHAIRMAN. Thank you. I thank all of you, gentlemen.

Gentlemen, I don't know how we could get better or more competent financial advice than you can offer. You represent the largest and most successful financial institutions in the country. A top-of-the-head estimate of the assets that you control by a member of the staff is \$250 billion. You are not exactly paupers or unsuccessful. Your business, as I understand it, is to make loans and make investments. This is the area where you have particular expertise. It seems to me that one of the functions, and one of the most important functions in our free system of a lender, of a bank, is to exercise discipline and not to lend money to those who can't repay it. And to make sure that when the money is loaned, it is likely to be repaid and if necessary to see that the money is handled efficiently. Yet, somehow that failed with respect to New York City.

My question is, will Federal aid, to bail out the investors in New York securities, dollar for dollar, prevent it happening elsewhere in the future? Doesn't this remove a very vital incentive that we have in our system, to see that when investors make an investment to have to discipline themselves, in losing their money if they don't insist it be repaid properly?

Mr. Wriston, would you like to start off?

Mr. WRISTON. Mr. Chairman. I appreciate the opportunity to respond to that. I agree with you. That the banker's function as a financial intermediary is to use his best judgment in making sound loans on behalf of its depositors and shareholders.

It is also clear that we guessed wrong and despite your best efforts you make some bad loans. That is written largely on the record.

The question in my mind is not really the financial consequences of New York City going under. We have a range of opinion on that. I am on the side of the spectrum that believes that the financial ruboff from such a default would be containable, with some trauma.

The thing that persuades me to join in this statement today is not that, but it is a social consequence. Only last week we got the number that if there were no debt service at all, if all debts were canceled, as it were, and put in suspended animation, there would be a billion dollars cash shortage between now and February. That means a social problem—no policemen, no firemen, and no welfare checks.

So, it seems to me that the problem has left the financial area. Important though that may be. And has moved directly into the social area of a society, whether people can afford to function at all without any essential services. If these numbers are correct, and we got them from the comptroller of the city of New York, then the problem is entirely beyond the financial problem. It is squarely in the social area here.

The CHAIRMAN. Well, Mr. Wriston, that is an excellent answer but it is not an answer to my question. My question was, as you recall, if the guarantee is provided, won't that eliminate much of the discipline investors are expected to exercise. If they are paid off dollar for dollar, why should they insist that when they make a loan the borrower make it good?

Mr. WRISTON. There is no question but that if the guarantee were given with no condition whatsoever, that would be the fact. If the guarantee were given with the conditions as Mr. Patterson cited in the

joint effort of Mr. Rockefeller and Mr. Patterson and myself, I don't think that would any longer obtain.

Mr. ROCKEFELLER. Any additional moneys?

The CHAIRMAN. Any additional.

Mr. ROCKEFELLER. It should be pointed out that in the last several months the New York City banks collectively have added some \$1,300 million to their holdings of city paper.

The CHAIRMAN. Well, you wouldn't advise others to make that investment now, absent a guarantee either, would you?

Mr. ROCKEFELLER. We feel that the time has come to find other sources of finance for the city's obligations.

The CHAIRMAN. Now, the question might be put this way: aren't you suggesting the taxpayers in this country, in general, to take a risk that you, yourself, wouldn't take and wouldn't recommend to others?

Mr. ROCKEFELLER. The banks along with other city and State institutions have given a great deal of support to the city and have urged that both the city and the State take measures to correct the bad practices which clearly led to the present situation.

The CHAIRMAN. May I interrupt to say there is no question that you have taken considerable risks. But now what you are asking us to do is transfer that to the general taxpayer. That is what a guarantee would do.

Mr. ROCKEFELLER. I was leading up to that, Mr. Chairman.

The CHAIRMAN. I beg your pardon.

Mr. ROCKEFELLER. My point was, I think we have reached a point now at which the city and State institutions have done as much as is properly possible. Unless the Federal Government is prepared to come in in the near future, default is inevitable. And in our judgment, as has been indicated from the papers you have just heard read, such a default would be very hurtful, and its ill-effects would extend to the country as a whole. Therefore, we are asking the taxpayer not to bail us out but to tide over the situation for a temporary period. This will be a lot less costly to the country and the taxpayer than the alternative of allowing the city to go into default and then to bear the consequences and disruptions arising out of that default.

The CHAIRMAN. Let me ask you, Mr. Patterson, following this up, we agree that the city must make considerable sacrifices and the State of New York must also, respectively, as well as what they have done in the past. However, I am still stuck with the problem that I think we are going to have trouble within the committee and on the Floor and with the American people, if they are wise enough to ask, and I am sure they are. How about the investors, are they going to be held without any further responsibility? Supposing we do this? Supposing Federal aid is provided, it is provided on the condition that the big institutions which have the capacity to do it, and your institutions certainly would have, would purchase for your portfolio, for retail purposes, unguaranteed city securities to a reasonable amount.

In other words, the Federal Government comes in with 80 percent of the guarantee and you come in with a purchase of one-fifth of the amount, perhaps a billion dollars, unguaranteed, to assist the Federal Government in recognizing the benefit that your organizations and the rest of the investor community would derive from this guarantee.

Mr. PATTERSON. Mr. Chairman, certainly we would consider any

plan or program or package, in connection with Federal assistance to try to correct the situation, which we think is critical. Certainly, before answering specifically I obviously would like to know more details about a program like that, and also get some technicians' advice. Generally, I feel in any program it should be absolutely perceived by the market to be a concise and complete program. We have seen several small programs that have been going from month to month. I think it is very important that whatever program is agreed upon, be complete and be perceived by the market to do the job, take care of New York City, so New York State can get back to the market and finance itself.

The CHAIRMAN. I wholeheartedly agree with you. I think if we are going to act, I think we should act on something that would clear up the problem. There is no point in helping with something on a short term program, I am saying. We should have a \$5 billion guarantee with the investment community picking up, say, a billion dollars of that. I am not asking for a commitment this afternoon. I am asking whether you consider that to be a reasonable proposition to consider?

Mr. PATTERSON. Answering, generally, without having a chance to think about it, one of the things that is very desirable is to get New York City paper out of the market, so it isn't there any longer. New York City then can go about its business and correct itself and keep the New York paper out of the market. That is one of the objectives that I think is desirable. Furthermore, I think, as you suggested a minute ago in your question to Mr. Rockefeller, at least from the bank standpoint, the banks have taken on quite a lot of New York City and New York paper. I don't know how much more, if any, they can take. I don't know what the public market would take at this juncture, and it makes it that much harder for the banks to help finance—

The CHAIRMAN. I realize that. I don't want to suggest anything impracticable. It seems to me one way we could more clearly understand your agreement that this would be sound, would be for you to come in on the action with the Federal Government. We are assured by everybody, if we will just guarantee it, it is a matter of timing, a matter of cash flow and the discipline can be exerted and so forth.

What I am asking is if you gentlemen who have been on top of this far more than anybody in the Senate could possibly have been, who have had to live with it, who made big investments in it, feel if it would be possible to make this further investment? I know it is a lot. Let me ask Mr. Wriston.

Mr. WRISTON. May I ask a question, Mr. Chairman? When you say 80 percent, do you mean each individual bond is guaranteed 80 percent by the Government or two classes of securities, one guaranteed and one not guaranteed?

The CHAIRMAN. The latter is correct. I am asking, as a matter of guarantee, conditioned upon guarantee, it would seem to me, if what we have been told about the guarantee is correct, if the Federal Government is not going to be victimized, then there shouldn't be any real problem with the private sector that puts in the additional billion dollars?

Mr. WRISTON. When you speak of the private sector you presuppose I believe, that majority of the States and cities that are held by banking institutions. There are a lot of estimates around, but a good many of them suggest that a good deal more than half of all the outstand-

ing debt of city and States are, in fact, held by individuals scattered across this country. You would run into a practical problem, through the individuals having their bonds redeemed and through the institutions by a disproportionate share of an unguaranteed issue. That is another practical problem.

I do not believe myself that such a scheme would be feasible, because I don't believe that the banks in New York City would have the room in their portfolio to take it on. You might ask Mr. Clausen, but I would think that the banks out of town would have very little interest.

The CHAIRMAN. Well, before Mr. Clausen gets in on this, let me just say, if this guarantee comes through, this is short-term paper, to some extent. It is going to be rolled over. Why can't you—why won't that free money that you could put into unguaranteed obligations here with the understanding that there is substantial guarantee and indications that New York is going to make it?

Mr. WRISTON. We have already agreed to roll over some \$550 million, unguaranteed, for a year. So that has already been done. So that money will not be coming up in maturity. Quite the contrary. That maturity has been stretched out.

The CHAIRMAN. Mr. Clausen?

Mr. CLAUSEN. Mr. Chairman, I would like to go to the form. You are talking about a guarantee. In the testimony this morning, it was always a guarantee. I believe that my testimony has indicated that some form of Federal assistance is not even debatable. We have got to have some form of Federal assistance.

The CHAIRMAN. It is debatable in the Congress.

Mr. CLAUSEN. We also feel that logic dictates that any form of Federal assistance, related to the plight of New York City and municipal bond markets, the State of New York, et cetera, has to have strong teeth, strong conditions to make it unattractive for anybody else. We don't want to have a precedent set here. The best way to accomplish that, in my opinion, I humbly submit, is not a guarantee, but a loan.

Guarantees, when issued cannot be cranked back or withdrawn in the event the city of New York does not live up to the criteria and the conditions that cause a guarantee to be issued in the first place because these obligations will be purchased by investors, spread all over. Two-thirds, or thereabouts, clearly a very strong majority of the obligations of the city of New York, are being held by individuals and not by banks, and you can't track down the holders of those obligations in the future, these purchases now, mind you, having the guarantee of the U.S. Government.

The way you can exact control is the way we make loans and investments. We put the barrel of the gun right at the borrower, and you have a maturity, a short-term maturity. Unless he lives up to the obligations, you can move in in a creditor role. If you guarantee, you don't have the power, strength or durability that a direct creditor has.

The CHAIRMAN. It depends on what you write into your guarantee. It depends on how you guarantee. It depends on the turnover you guarantee.

It seems to me it is practical to say the guarantee will be conditioned upon performance. If they don't move toward a balanced budget, if they don't reduce their expenditures to match that, the guarantee doesn't follow through.

As one who has been in the Senate 18 years and as a member of the Appropriations Committee, it is harder to get a loan through the Congress than a guarantee. It is going to get difficult to get a guarantee through, if it can be achieved at all.

Mr. CLAUSEN. From a cost standpoint, we attached addendum for a loan rather than a guarantee. We suggest that the U.S. Treasury can borrow money the U.S. Government can borrow funds, far less expensively with the guarantee of the U.S. Government than any other agency.

Plus, there is a difference in the marketplace between even a taxable security by a municipality with the guarantee of the U.S. Government as compared with a taxable security without the guarantee of the U.S. Government.

The CHAIRMAN. My time is just about up. I would like to say, however, one of the reasons I suggest this, along with a number of other conditions that Senator Brooke and the rest of us on the committee are considering, is the condition we have to get some private participation in this—this seems to me to be one element that also would discourage this being overused or abused.

If you had to get, when you got a guarantee, a substantial amount of it, taken on a nonguaranteed basis by the private community, then I think we wouldn't have to worry as much, at least about many cities coming in.

My time is up.

Senator BROOKE. Thank you, Mr. Chairman. I would agree this is a very awesome and impressive battery of witnesses. I am clearly impressed with the statement which Mr. Patterson made on behalf of Mr. Rockefeller, Mr. Wriston, and himself, both for its candor and recognizing that you do have a self-interest here, and also for the balance that you have in this particular statement.

One question was asked of you, Mr. Wriston. I think in response thereto, you mentioned that you went to the city at the beginning of this year. I think you had meetings with the mayor and city officials in March of 1975.

Now, I asked the question of Mayor Beame and I think it is only fair to ask the question of you, and it is buttressed by this Congressional Budget Office report, which I referred to earlier, and has been widely cited in our hearing.

I read from page 14. "Many of the gimmicks which allowed the budget to appear to be balanced, were tolerated or even suggested by State officials, and certainly were not secrets to the banking community."

Obviously my question to you is, Why did you wait so long to come in? You must have known this crisis was building? Why didn't you try to protect, not only your bank, but the city and the State of New York as well?

Mr. WRISTON. I think when people suggest they knew of some of the gimmicks, I think it is true that some of the gimmicks were known about, such as charging current expenses to capital budgets.

The mayor made some rather impassioned statements justifying those on an accounting basis, but the clear facts are that the accounting system of the city of New York defies you finding out precisely what all the numbers are.

You are quite correct, I think, that we should have known earlier. We did not, but part of that is that the whole system was designed to prevent anybody from finding out. That is true of the rating services. It is true of the State and it was true of ourselves.

We are undoubtedly wrong in not getting it earlier, but as soon as we did find out with any certainty, we moved as rapidly as we could.

Senator BROOKE. You don't lend money to private borrowers under those same conditions, do you?

Mr. WRISTON. I think if an elected mayor certified to you that the budget is balanced and you have the controller, who is also elected, certifying numbers, a person has a certain right to rely on that in the same manner you would rely on an independent auditor in a private firm.

Senator BROOKE. You did act on reliance of that certification?

Mr. WRISTON. Yes, sir.

Senator BROOKE. Now, Mr. Patterson, you made some recommendations in your statement. One was that no new Federal bureaucracy be created to oversee or administer an aid program. As you recall, in the Lockheed—I am scared to use the word “bail out,” I don't want to use it, I don't want to upset my good friend and colleague, Senator Javits, but the Lockheed bail out, and I voted against the Lockheed bail out—in that case we created an Emergency Loan Guarante Board.

You remember we did establish a board, the Emergency Loan Guarantee Board at that time consisting of the Secretary of Treasury, Chairman of the Federal Reserve and I think, Chairman of the Security Exchange, SEC.

What would you do under those circumstances? You don't want a new Federal bureaucracy. Who would oversee, who would administer, who would protect the Federal Government for the \$5 billion?

Mr. PATTERSON. Well, Senator Brooke, as we said, we would hope that would be an only-time, one-time use of it. You would have to make available auditors.

I favor a loan approach, as Mr. Clausen said, but I recognize, Mr. Chairman, there are some questions on it. I would think a small group centered in the Treasury Department, should administer the loan or the guarantee, and not have a large bureaucracy. I don't think there should be so many instances that it would take a good deal of time.

Senator BROOKE. If we have to step in, we might be faced with having to work with the labor unions in the city. Did you consider that possibility?

Mr. PATTERSON. I would hope that wouldn't be true, Senator Brooke. The Emergency Control Board now, with the Governor and three of his representatives, is presumably in a position to see that fiscal discipline is properly maintained and that the figures including all the labor contracts and the whole operation are going to be on a viable, credible basis.

I would hope that would be adequate and as we said in our paper, we think that should be the responsibility of the State to undertake that.

Senator BROOKE. Now, you say you would recommend that some substantial portion of a guarantee be made available only for a limited term of, say, a year, with renewals dependent upon responsible self-discipline by the users of the fund.

What did you have in mind?

Mr. PATTERSON. The point there, Senator Brooke, as Mr. Clausen mentioned, was to keep a short string on the borrower and be able to actually make sure that the discipline figures that you called for are being met; either a short-term loan that would come due, or a guarantee that you can just keep it current, so you don't just shut your eyes for 10 years and say, go ahead.

Senator BROOKE. As I understand it, you would have this legislation cover all of the 50 States, but you would draw the criteria such that only New York would qualify.

Now, do you intentionally there rule out the possibility that other States, for example, my own State of Massachusetts, which is not in the best financial condition at the present time, would not be eligible, under these criteria?

Mr. PATTERSON. It is not our intention to rule out any other States. The only point we made there, we think the criteria should be made so strict, the discipline so harsh, that only States in the extreme position New York is in, would be asking for it. There is no intention to forbid other States to apply for it.

Senator BROOKE. Now, Mr. Rockefeller, about a Federal guarantee for debt, we would in effect, it would appear to me, make the least creditworthy borrower into the most creditworthy borrower. Now, New York would presumably step to the head of the line. I don't see how this could help other cities. In fact, I think it might indirectly hurt them, by diverting funds to New York which would ordinarily go to other cities.

For example, if other cities are not hurt by New York City receiving a Federal guarantee, I fail to see how they are helped. Will you comment on that?

Mr. ROCKEFELLER. Well, here again, Senator Brooke, is the reason I share Mr. Clausen's and Mr. Patterson's belief, that a one-shot loan is preferable to a guarantee. Although I understand the Chairman's concern over the feasibility of getting a loan through Congress, I also feel that it would avoid the issue you have just raised. The proposal would be not to put all New York City or New York State obligations on a preferential basis, but would apply only to a limited number of them for a specific duration. This would open up the market for them once again on a fair basis.

We have also made it quite explicit here, that if this were to be done, the obligations covered by the guarantee would be different from other municipal issues in that they would be taxable rather than tax exempt.

Again, we think this makes an important distinction. It makes the proposal viable, from the point of view which you raised.

Senator BROOKE. If just one city's bonds were guaranteed by the Federal Government, I obviously would assume there would be much less risk involved there, and I would tend to buy those bonds rather than other bonds not guaranteed by the Federal Government. We would have a situation in the bond market, where only one city—namely the City of New York—which I have classified as the least creditworthy at the present time, would be in a very preferential position and one which might be somewhat harmful to other cities, without the advantage of having their bonds guaranteed.

Mr. ROCKEFELLER. Senator, I think the significant difference is the fact that they would be taxable. No other State or municipality's bonds are taxable. Therefore, the effective rates of return to the purchaser would be significantly lower.

Senator BROOKE. You think the tax exemption would make it different and they would go for the tax exemption rather than the security of the bond itself?

Mr. ROCKEFELLER. This is our belief and it would apply for a limited time.

Senator BROOKE. Senator Proxmire made a proposal to Mr. Patterson and Mr. Wriston of an 80-percent guarantee by the Federal Government and 20-percent purchase by private institutions. Can I make a proposal of 50? How would you consider that?

The CHAIRMAN. It made my proposal look pretty good, doesn't it?

Mr. ROCKEFELLER. The difficulty is that this is the kind of proposal that the city and State have been making to the banks for the past weeks. They have offered to provide other new sources, only if the banks "go along." Until yesterday, we did go along. I don't say that with Federal participation there wouldn't be room for possible further participation by banks. However, the banks are already being criticized around the country for holding as large amounts of New York City and New York State obligations as they presently do.

The soundness and viability of the banks in the eyes of the public is a precious commodity. That confidence could be shaken, if the banks were to assume significantly larger amounts of these obligations in their portfolios, particularly in the absence of a secure guarantee.

Therefore, while I would certainly not preclude looking at anything you or the chairman or others would propose, I do think there are some serious obstacles to massive further investment by commercial banks.

Senator BROOKE. If the Federal Government is required to make a 100 percent guarantee, we very well might be accused, not only of bailing out New York but pulling your "chestnuts out of the fire." As you know, you do have a large municipal bond portfolio; in fact, you have a large bank portfolio.

I think it was mentioned in the statement Mr. Patterson read that you did have some self-interest. I am not as optimistic as Mr. Clausen that this is not even debatable. We have some hurdles to get over, and we are going to have some difficulty in coming up with some plan, that can be accepted by this committee, and then the Senate, and then the House, and then by an administration that already has stated its position relative to this legislation. Certainly, if we got a veto on it, it would be much more difficult to override a Presidential veto, in the Senate and House on an issue like that. So we have a long way to go to giving some relief to the city of New York.

When we say we have a long way to go—even though Senator Proxmire, to his credit, has been expediting this particular matter, for which I am sure you are grateful—you very well know we can be debating this for a month or so.

I think we debated the Lockheed loan for——

The CHAIRMAN. Not long enough.

Senator BROOKE. Not for our purposes anyway. But for a long time. And if you run into a Presidential veto, we could be beyond the December 1 deadline. So, we have some serious problems and we are

all looking for some guidance, that would be acceptable and helpful to the city of New York.

Mr. ROCKEFELLER. Just one more point in reference to the question you addressed to me, in referring to the "bailout" of the New York banks' position.

Senator BROOKE. That was "chestnuts out of the fire." The "bailout" was for New York.

Mr. ROCKEFELLER. I think it is important to remember that the banks' holdings of city obligations account for only about 10 percent of the total. In other words, 90 percent of those obligations are in the hands of the public, much of which lives outside of New York City.

Senator BROOKE. Yes. That was testified to. I didn't mean New York City alone. I was speaking of others, too.

Mr. WRISTON. I just wanted to make one point. All markets operate on confidence. They operate on what they perceive to be facts, rather than certified by a mayor or CPA. One of the facts that the municipal market has operated on—and we believe the legal opinions by prestigious firms that said the first claim of taxes was to pay bond holders. In the real world, we have now found out something that we might have known before, that that was not true. In the real world, the first claim, the taxes are going to pay off the city services. So, in my opinion at least, I think you have to take into account the fact that the whole municipal market, whether or not New York is bailed out, will assume a different shape and a different configuration in the future.

That is, taxes will obviously go to maintain the city services, prior to the bondholders. So I think you have a whole different fabric, that you have to consider, whether in any State or any municipality, no matter what happens.

Senator BROOKE. Thank you, Mr. Wriston. I certainly respect your opinion. I am pleased to hear you say that. Several things are clear to me. First, the city feels that it has done all that it can do. Second, the State feels it has done all it can do—I am not convinced of that personally, with regard to the State, particularly.

Third, your industry has done all it can do, and you have gone the extra mile in these last few months. I am sure.

Mr. Chairman, I go back to you on this: We have heard from the banking industry and we have heard from the city officials in New York. But I am just wondering whether we are going to have some input by objective economists, leading economists in the country, or if they would submit something for the record that would help us as to the impact.

I think in your statement, Mr. Patterson, you said no one really knows what is going to happen. A lot of this has to be speculation. But to the degree those economists haven't accomplished too much as far as the economy is concerned, and I must be honest about that, at least they might be helpful to us in predicting some of the dire consequences of our acts. I hope that might be pursued.

The CHAIRMAN. Senator Brooke, we certainly will consider it. As you know, somebody said you can lay all the economists in the world end-to-end and they still wouldn't come to a conclusion. We have about as many opinions as you can find economists. We have heard all kinds of very competent people discuss the effects, possible economic effects.

Paul McCracken has written with considerable conviction that a New York default could conceivably be the kind of event that would provide, set off possibly a worldwide depression. And he is an economist of great ability.

Senator BROOKE. How about Mr. Friedman?

The CHAIRMAN. We are requesting opinions from Mr. Friedman and Paul Samuelson, but they will not appear on this subject. They will appear November 6.

If we are going to mark up this bill on Tuesday—

Senator BROOKE. I would ask that we get statements.

The CHAIRMAN. I know Mr. Buckley asked why we wouldn't mark up this bill on Tuesday. I would say to Mr. Buckley, the reason, we have been held up by Arthur Burns and others, and I think they are right, that uncertainty is one of the problems here. You need a decision now, yes or no.

It seems to me, a no decision would be better than a decision 6 months from now of yes. I think you need an answer.

Senator BROOKE. I concur with you, Mr. Chairman, on that.

Senator EAGLETON. On this same subject, what might be called crystal ball gazing, I noticed that the stock market behaved in a rather civilized, unchaotic manner yesterday. Further, I notice a disparity of opinions reflected here this afternoon. Mr. Wriston said, "The ruboff of the New York City default would be containable," but Mr. Rauch, from Philadelphia, indicates that there could be a calamity if New York defaults.

I would like to ask the other five bankers, Do they share Mr. Wriston's optimism or Mr. Rauch's pessimism?

Mr. CLAUSEN. There is no question in my mind, Senator Eagleton, if New York goes into default, it would have a serious impact upon the creditworthiness of the State of New York and the viability in the marketplace, domestically and internationally.

Now it is not going to be good. Clearly I think we would all share that opinion. How bad it is going to be is judgmental. I think that on a lesser-of-evils basis, our objective here is to keep the patient alive so we can effect a cure. If you are satisfied a cure can be effected, on a lesser-of-evils basis, then some form of Federal assistance is the way to go to give the patient the time to cure itself and get back on its feet and to use the approach in a form that will have the greatest stability, will not disrupt the marketplace, or create prejudices or imbalances or biases in the marketplace. A guarantee does create a bias in the marketplace. A loan does not.

A loan absorbs and takes the overhang, the so-called New York City and agency bonds, out of circulation. You have a more even-handed approach in the marketplace than a guarantee.

But clearly if New York went to default, if we couldn't effect a cure, it would have a serious impact on the marketplace, but it would not be the end of the world.

I am not joining in Mr. Rauch's pessimism, if that is what you categorized my friend on my right as saying, and I don't think he said that. I think it would have a bad impact on the marketplace. I would hope we could avoid that.

Senator EAGLETON. Do you think the ruboff of a New York City default would be containable, Mr. Patterson?

Mr. PATTERSON. Senator, as Secretary Simon said, the critical part is the psychological impact. It is unknown. It is unknowable. It is hard to understand, what effect it will have on confidence, and the psychology that comes from a default like this, of this size, is hard to predict and hard to control. Already we have seen that it is not containable in the sense of the effect it has had on other New York State and indeed other municipalities around.

My own view is, it is not containable.

Senator EAGLETON. Is not containable?

Mr. PATTERSON. Is not containable. It has been demonstrated that is not containable. I can't quantify it. I don't know exactly what the fallout would be, but I think it could have an effect, as Dr. Burns said, on the economy, depending upon the degree.

Senator EAGLETON. Mr. Rockefeller?

Mr. ROCKEFELLER. I share Mr. Patterson's view. The budget director of New York State, referring to the impact of a possible New York City default, has said that the State would itself default within 30 days. If that is so, the default of the largest city in the country would have to have a very serious impact on the country as a whole. As you noted, the stock market did not react very strongly yesterday, when default was imminent. However, and more importantly, trading in tax-exempt bonds came to a standstill. There was virtually no trading in any tax-exempt bonds. I think the increase in bond yields—and the decrease in prices of municipal bonds during the past several months—is an indication of a rational fear.

It is my belief that the psychological effects of a default could be most important to national bond markets. There are sufficient danger signals now evident to make the risk of default unacceptable.

Senator EAGLETON. Mr. Crawford?

Mr. CRAWFORD. I think insofar as savings banks are concerned, the risk insofar as municipal securities are concerned, specifically New York, is not a very great problem, because as this committee knows, our institutions are not heavy purchasers of municipals. About one-half of 1 percent, I believe, of the assets of our banks are invested in all types of State and municipal obligations.

I think the periphereal effects that I fear might take place, are things that could be very damaging. I refer, of course, to not only the social costs that Mr. Wriston referred to, which are very tragic, but also if we had very massive layoffs, to exacerbate the already rather weak economy, we could see in New York City, I am sure, a great deal more abandonment of housing, a great deal more deterioration of real estate credit, and a great deal less building, not only in New York but throughout the country. All of these things, of course, would be very damaging to any recovery. Of course, the area in which our institutions, as you know, provide most of our investment funds, is the mortgage area. It would be the periphereal effects rather than direct effect on our municipal holdings that I would fear.

Senator EAGLETON. Mr. Albright?

Mr. ALBRIGHT. I really don't have anything to add, Senator, except to say I generally concur in a sense with what has been said.

Senator EAGLETON. I would like to ask a question of Messrs. Wriston, Patterson, and Rockefeller. This morning, Mayor Landrieu, on behalf of the American Conference of Mayors, drew the conclusion that New York City's union wage scales and the New York City pen-

sion retirement system were not out of line, when compared with other cities, bearing in mind that New York City has broader governmental obligations than most cities do.

I take it that First City National, Chase, and Morgan all have made some analysis of New York's wage scales for its public employees and its pension systems. I will ask the three of you the rather simple question: Do you agree with Mr. Landrieu's evaluation there is nothing out of line in New York City; it is just the way it should be; or do you find the wage scales and the pension benefits are somewhat excessive?

Mr. PATTERSON. I am sorry, Senator. I don't have enough information to be able to comment on that.

The CHAIRMAN. Mr. Wriston?

Mr. WRISTON. I think it is very difficult to compare any total compensation packages when you crank in the fringes and crank in straight salary and you crank in retirement dates.

I think the perception is that the fringe benefits in the city of New York are higher than most communities in the world.

Some people can retire on more than their last annual salary after 20 years.

There are very few pension plans, I think, that provide that type of thing.

I couldn't tell—

Senator EAGLETON. The staff has corrected me. I think it is an important correction. The staff points out that Mayor Landrieu did not mention pensions. If he failed to mention pensions, then that in and of itself is significant. If he was talking about comparability of salaries, but specifically omitted any analysis of pensions, then such an omission is significant.

One final question. Mr. Rockefeller, the three of you in your joint statement seem to come down in support of the federalization of welfare. I take it that is one of the recommendations you want Congress to look at in ensuing months ahead.

Mr. Rockefeller, your brother, about a dozen or so years ago, recommended this, when he was Governor of New York. I thought it was a good recommendation then and I think so now.

Does your brother still adhere to that view, namely to federalization of welfare?

Mr. ROCKEFELLER. I have not had a discussion of this subject with him in recent times. I don't know whether he does or not.

I think I should say that we on this panel did not specifically recommend that welfare be federalized. Rather, we suggest that it be given careful study by the Congress.

Clearly welfare is a major item in New York City's budget. It is a very complex issue that involves many things, including the comparability of welfare payments in different parts of the country and the impact of migrations of people which have resulted.

Our feeling was that while we haven't examined the subject enough to be able to make a firm recommendation in Congress, it clearly was something that needs a lot more study.

Senator EAGLETON. Thank you very much.

The CHAIRMAN. Senator Javits?

Senator JAVITS. Thank you.

Gentlemen, one thing stands out grimly underlined, what Chairman Proxmire already said, that is, you all agree if the United States doesn't step in, default is inevitable.

That is found at the top of page 8 in the joint statement by the three leading commercial bankers in our city.

"We find ourselves obliged to acknowledge a Federal role is inescapable if default is to be avoided."

It appears in Mr. Clausen's statement. He says, "In my judgment, the necessity for Federal support for New York City is neither optional or debatable. Default must be averted. What remains to be resolved is the form that such Federal support should take."

And Mr Crawford says, "Unless the Federal Government acts to aid the city directly, or through the State, a default by the city on its debt is inevitable."

Can we say, then, it is your joint opinion that unless the Federal Government does something—something adequate, because I think we have been kind of fencing around with that, and I would like to come to that in a moment—default is inevitable?

Is there any disagreement on that?

Now, the next part, as I see it, we are derelict in the Congress. As a practical matter, we have no bankruptcy status. There is no trough into which New York State's head can fall—Not even that, with dignity.

All you have is a 120-day stay, possibly another 30, by the State.

Do you consider that an element, serious element, also in the uncertainty surrounding this?

Can we all agree on that?

Fine.

Could we all agree—and please demur if anyone disagrees—that the result is uncertain at the least, ranging from everything like perhaps touching of a world depression, like Credit-Anstalt did in 1932—and that was a lot smaller institution than New York City—to possibly being contained and not having more than 1, 2 years', a few months' effect on the municipal bond market and perhaps some shakeup of the stock market.

But nobody knows. Absolutely. It is absolutely a dark alley.

Mr. WRISTON. Senator Javits, Senator Eagleton left that question, the last portion of what I said was left off. The question is moot.

What I said, while the financial basis might be sustained in my opinion the social trauma could not. So the question of the financial ripple is moot, in my opinion.

If you have a billion-dollar cumulative cash deficit with no payment on debt, which is what the comptroller in New York's figures show, and we are relying on those, then you have payless paydays. You have no policemen. You have no firemen.

I think the conversation about the ripple effect is moot at this point.

The real point is: Can eight million people stand that social trauma?

That is where I believe we cannot.

Senator JAVITS. Could we add to your proposition, Mr. Wriston, and I thoroughly agree, that when and if the Federal Government steps in under the circumstances of actual default, it is going to be a lot more expensive and it isn't going to be a guarantee; it is going to be hard money in addition to what it will do in tearing the rest of the country apart?

May I ask you this final question: You three gentlemen are major sellers of municipal securities, that is the three great banks in New York, and there are others at the table and that includes Bank of America, of course, in their area of the country—Mr. Crawford, though you had a relatively small amount, in absolute terms it is large, you are a buyer of municipals.

Could you each give your advice to the Committee as to what should go into a bill? For example, we talk about a guarantee. Someone mentioned a 1-year obligation. That guarantee can be conditioned upon the fact that the State of New York should make its machinery operate according to the rules the United States lays down, but the securities buyer has no conditional guarantee. If New York City doesn't pay, then like the FHA or some other provisions which would be cranked into the law, the United States would back it up.

So a question I would like to ask you is this: As sellers of the bonds, what do you call, how would you enforce this discipline? Would you leave it for the State? Would you ask for a State participation? Would you ask for private participation?

Point one. Point two: these bonds will be taxable, they will be short term and they will be guaranteed. Can they be sold? Are there buyers for such bonds? Even if they do carry this guarantee.

Point three: what about those who present their notes? How can we get them to, or persuade them to, or make them accept these perfectly good, valid, U.S. Government-guaranteed obligations, rather than the hard cash at the windows? Because that, after all, is a big problem.

Now, you are the men who have the expertise in this field. Anything you could tell us, it seems to me, could be very helpful to this committee, as it gets to work and drafts a bill, if one is to be reported out.

The CHAIRMAN. Mr. Patterson?

MR. PATTERSON. Let me start off on that, Senator Javits. Obviously, any kind of plan is going to be complex and I don't want to go into very many details here, but I would say, yes, my view would be, yes, the State should have the responsibility, of monitoring and exercising the discipline which is built in.

I think that guaranteed bonds of New York State, whoever the named borrower is, with a Federal guarantee unconditional guarantee, certainly can be sold, but I think they would be sold at a more favorable price as straight Federal credit.

Lastly, I do not feel any plan should be set up to ask holders to exchange their bonds, when they become due, for these Federal guaranteed bonds. I think they should pay cash for maturities and that the funds should be provided through the issuance of bonds or a loan or whatever comes out of committee.

MR. WRISTON. I agree with Mr. Patterson. I have nothing to add.

Senator JAVITS. Mr. Rockefeller?

MR. ROCKEFELLER. I very much agree with Mr. Patterson. The justification of paying cash for maturities, rather than trying to enforce an exchange of paper, would save time in enabling the city to create a market for its securities.

If bond holders were obliged to exchange existing bonds for another issue—which they may or may not want to do—they are less likely to be in the market for New York City paper. Therefore, I think

it is important to pay them off as was originally indicated would be done.

Senator JAVITS. Mr. Clausen?

Mr. CLAUSEN. Senator Javits, as you know, Bank America is one of the biggest underwriters of municipal bonds. I would agree with the comments before, but I would speak particularly to the question as to whether the present holders of New York City obligations, or agency obligations, should be required to roll into Government guarantees.

You are talking about two different markets. Tax exempt markets already own the securities. That is not the market to attract necessarily to a taxable guaranteed obligation.

I would strongly endorse Mr. Patterson's comments earlier that those should be cashed out and rolled into a new market attracted to the Government guarantee.

Senator JAVITS. I gather all would agree that this has to be a one-shot operation and it has to be large enough to be complete. Otherwise it just won't work. The bridge will be a foot short. We all agree on it.

Thank you.

The CHAIRMAN. Thank you, Senator Javits.

I am concerned, Mr. Patterson, with a statement you made, and you made it on behalf of the two other distinguished gentlemen, that it should be a 1-year guarantee.

I got the impression—I tend to favor that. I hope we can do it. I wonder if it is practical. That would give us the kind of control that I like very much. On the other hand, it doesn't give you as much of an opportunity to extend your maturities which I think is a big part of the problem that New York City faces that makes it unique.

Mr. PATTERSON. Mr. Chairman, it was a substantial portion of any amount lent or guaranteed that we said should be for a limited term, say for 1-year.

The CHAIRMAN. That's correct?

Mr. PATTERSON. Yes. Certainly you have to stretch out the short-term debt to get it off the market. The suggestion of making it a short-term loan, or a short maturity, was simply so you can pull the hook up once a year—and take a look and say are they doing what we told them to. It wasn't the whole package.

Senator BROOKE. It wasn't the whole guarantee. It was a substantial portion of it. Is that correct?

Mr. PATTERSON. Yes.

Mr. CRAWFORD. Mr. Chairman, I would like to say, I hope we don't give the impression here that this problem in New York can be solved in the long run by merely bringing the city to a fiscally sound method of dealing with finances, and with some type of one-shot guarantee or even loan. The thing I believe to be the key in the long run, simply has to be Federal assumption of the welfare and other poverty-related costs in New York City. I don't care how well New York City is run, I don't think it can take on the enormous cost of public assistance.

The CHAIRMAN. We appreciate that very much. You may or may not be right. This Committee doesn't deal with the welfare situation. That has to be done by another Committee. After all, other cities and States together, and counties together, have a similar problem. Not as bad as New York, perhaps, but similar if you consider the entire entity. At any rate, I just don't think that is necessarily a solution to

the welfare problem, either. If the Federal Government administers the welfare, I dread to think of the inefficiency and additional cost that might develop, although we might have to go that route.

Governor Carey estimated there is a need for about a \$5 billion Federal guarantee. Do you think that figure is about right? Is it too high or too low?

Mr. Patterson, you have worked very hard on this. Can you give us some help?

Mr. PATTERSON. Subject to confirmation, that is about the figure that we had in mind, a \$5 billion figure should do it.

The CHAIRMAN. All right. Do you gentlemen acknowledge that there would be a greater discipline on New York if it should default, than if it should not default? If they do default, there is no question that there has to be some cruel, painful, extensive reduction in services, reduction in spending, that may be socially very bad, but it is going to be achieved, I would think. If they don't default, this has to be engineered by monitoring, and I just wonder if you can get anything like the same character or discipline without a default. Your opinions would be useful because you have been watching this now for a number of months.

Mr. WRISTON. Mr. Chairman, I think the Financial Control Board, which is now in place, as you know, a statutory board passed by the State, has the power, has the statutory power, has the Governor as its chairman. I think that it demonstrated the fact, by rejecting the teacher settlement, which was not a very popular thing to do on a political basis, that they have in fact put tremendous teeth into the financial discipline process.

I think it is going to take a long time, but I personally believe that the mechanism is in place that can in fact achieve what you are suggesting, probably better than by going through a default.

The CHAIRMAN. Secretary Simon has been the most eloquent champion of the default route. He argued that the experience has been, that as long as the city thinks it is about to lose the support of the State, or that it may have to go into default, that the discipline is effective and they make some cutbacks and they make commitments that move them toward a balanced budget, but once they begin to ease up, and presumably once the guarantee is provided, there might be a considerable easing, all of that discipline is lost or much of the discipline is lost.

What is the answer to Secretary Simon's position?

Mr. WRISTON. I am not aware that there has been anything in the United States of America that is comparable to the Financial Control Board. As far as I know, the statute passed by the New York legislature is unique, and the entire financial control of the city is basically in the hands of that control board, which includes three outside people, and the Governor and the Comptroller of the State, and the mayor of New York. The majority vote is with the State.

Now, there may have been this kind of discipline before in the United States, but I have never heard about it.

The CHAIRMAN. Your observation is that it is working?

Mr. WRISTON. Yes. I think it is working. I think the people in it are very dedicated, very sincere and they are grappling with a bean bag, trying to find out what the numbers are.

The CHAIRMAN. Grappling with a what?

Mr. WRISTON. I think a bean bag. Just to get a shape on the number with that budgetary procedure, but I personally believe they are making a very sound, tough effort. If that continues, which I expect it will, the discipline of which you speak will continue.

The CHAIRMAN. Mr. Rockefeller.

Mr. ROCKEFELLER. I agree completely with what Mr. Wriston said. In addition, it is my understanding that in the event of recall, under the present laws of the State, the financial control of the city would be taken out of the hands of the Financial Control Board, and would go back completely into the hands of the mayor.

The CHAIRMAN. I didn't know that. That is a very interesting revelation.

Mr. ROCKEFELLER. The mayor has not completely achieved the fiscal discipline needed to rectify the city's problems.

The CHAIRMAN. One other question on default. As I understand it, the operating budget needs \$1 billion in order to bring it into balance, the operating budget I am talking about. Now, that billion, it's a \$12.3 billion budget. That means about 8 percent reduction would bring the operating budget into balance. Why would that be such a devastating impact?

Mr. ROCKEFELLER. I think there is a misunderstanding. I believe the figure is three times the percentage you suggested. It is true that more income would come in later, but there is an immediate cash problem of \$1 billion.

The CHAIRMAN. That means, as I understand it, about half the budget is uncontrollable. That means about a 50-percent cut in what is controllable. That could mean paralysis of city services and possibly an absolute necessity of massive Federal intervention with a far greater cost.

Senator Brooke?

Senator BROOKE. Mr. Chairman, I don't want to dramatize an already dramatic situation, but I can't get away from feeling like some of you must have felt on the Gulf of Tonkin resolution.

I was not in the Senate at the time and we got to Vietnam and look what it costs us.

It seems to me—there are some imponderables here. First of all, the temporary situation. We are talking about temporary, emergency guarantees that will last no more than 3 years.

Well, in my limited time in the Senate—I am now in my ninth year—I have never seen any temporary emergency programs. There is just no such thing as temporary in the Federal Government. Everything becomes permanent. That is No. 1.

And second, then, and I heard you argue this point before, if we provide a grant for the city of New York and the city fails to reform its finances, it seems to me all the arguments you have made for providing this assistance will be just as valid then as now.

Any argument that you make now will be valid next year, 2 years from now, or 3 years from now, if the city defaults.

You talked about the Financial Control Board. Well, that is really not been tested yet. You have some wonderful people on it, to be sure.

Mr. Wurf is not going to testify before us, but I am sitting here thinking, how can you control a union? Suppose you have a general strike in New York City—and there has been one threatened—what happens then?

These are factors that we really have to be concerned with. Not just the default, that the Federal Government would be out \$5 billion, but that may not be the end of it.

You know, New York City is not going to be in any better position to go down a year from now, 2 years from now, 3 years from now, 10 years from now, than it is today.

These are very real problems. It is not a matter of calling it a "bail-out" or not "letting New York go down the drain." That is oversimplification of it.

These are very serious problems.

This might be one of the most important decisions that this Congress makes, frankly, and I think you men of business and of the banking industry must recognize where we are going, and what the consequences of it may be. You have got to balance that with what actually will be the impact if we have default.

I just hope that there is sufficient evidence when we really get down to the markup of this legislation, that we can call upon it to help us, because that is what these hearings are for, to help us make a wise decision.

I don't know if anybody in his right mind who really wants to see New York City go down the drain, and I don't believe it is going down the drain, either. But the question is: what can we do here in the Congress at this time to alleviate this condition until hopefully the city can get back its creditworthiness?

That is maybe not a question. It might be a speech. I don't know. But that is the way one member of the Banking Committee feels—and I feel very, very strongly.

The CHAIRMAN. Let me ask, Mr. Wriston, would you like to comment on that observation?

As I understand it, Senator Brooke is saying in addition to guaranty, or aside and apart from a guaranty, if we don't provide the guaranty, what can we do fundamentally.

You suggested a welfare takeover by the Federal Government. What can we do?

Senator BROOKE. And if they default, if they do not bring about the reforms and they default again, what do we do then?

The CHAIRMAN. Mr. Wriston, do you want to take it?

Mr. WRISTON. I don't think there is any question we have asked more of our society than it is capable of delivering, and we have told everybody that the money is unlimited, the resources are unlimited, and we have promised more than we can deliver.

At some point those two curves cross.

In the city of New York, they have now crossed.

I agree with you it is a fundamental problem. If you always spend more money than you earn, eventually your credit runs out. That is basically what happened to us.

I agree with you it is a serious national issue, getting up even on the Federal level and on the State level.

The differences in the Federal level, of course, you can print the money to pay the debt. You can't do that on the State and city level.

But I personally believe that the city and State of New York through the Financial Control Board, has put a discipline on the city that no other municipality has ever had before.

Now, I can't tell you that a year from now we will have been successful with this mechanism. But I do believe, very strongly, that there is a better chance of that succeeding—so that you will not have a repetition of this—than we have ever had before.

Senator JAVITS. Can I have a follow up question to that very question?

The CHAIRMAN. Indeed.

Senator JAVITS. Don't you have the additional lock on this situation that New York State's own credit is in such jeopardy that it is greatly at risk unless it really makes this work and very firmly?

No matter what they might like to do, they have to do it.

Mr. WRISTON. I think they have learned, Senator. This thing started when the State of New York defaulted on the Urban Development Corporation bonds. And when those bonds remained unpaid, the market started to close.

So this started at the State level, in my opinion. Eventually that default was cured, but the damage had already been done to the marketplace.

You are quite right. The two of them are inextricably linked at this time.

Senator JAVITS. That would be an additional guaranty to the United States.

Mr. WRISTON. And also they would learn they have to pay their debts or the marketplace closes.

Senator JAVITS. Thank you.

The CHAIRMAN. Gentlemen, thank you very, very much. It is most impressive that you distinguished gentlemen would have come down to Washington and given up your Saturday and show how strongly you feel.

Thank you very much.

Our final panel consists of Mr. Peter Peterson, chairman of Lehman Bros., Inc., and Mr. Martin Mayer, distinguished author.

#### **STATEMENTS OF PETER G. PETERSON, CHAIRMAN, LEHMAN BROS., INC., AND MARTIN MAYER, AUTHOR**

The CHAIRMAN. Gentlemen, we are indebted to you. I must say we admire your endurance and your patience.

Mr. Peterson, will you lead off, sir?

Mr. PETERSON. Thank you, Mr. chairman. I would like to say first of all, I am testifying as an independent citizen. I am not speaking for my partners. That would be both impossible and selfdestructive.

As is easy on these difficulty issues, one can polarize pretty quickly. If you're for helping New York, you are against financial discipline and you are for easy and loose living.

If you are against helping New York, you are lacking in compassion—a heartless ideolog.

Is there a solution that combines discipline and compassion? I am confident there is.

Before we invent solutions, I think we should at least invent the question. The appropriate question to me is not how to "bail out" New York, so that it can continue its past inexcusable fiscal irresponsibility. Any solution must be in the context of a stern system of fiscal responsibility, similar to that contained in New York State's recently enacted Emergency Financial Control Act.

The precedent which would be set by aiding New York City without requiring firm financial discipline is mind boggling. So I would suggest that the appropriate question as has been discussed today, is can New York City be aided by using the State as a vehicle for a limited transitional period during which it must obtain balanced budgets in accordance with commitments to achieve such balanced budgets, and agreed upon tough remedies, if it does not?

If that is the question, then I think we can proceed to develop the kind of solutions that we should strive for.

First, it seems to me, we must grasp this opportunity to try to get a total solution and not a piecemeal assortment of band-aids.

Second, we should strive for a long-term solution and avoid the enormous temptation for a short-term fix.

If there is one principle that characterizes the deterioration of any capital market, it is the uncertainty principle.

Prolonged uncertainty metastasizes the malignancy afflicting New York, irrespective of whether it was terminal initially or not. A lack of decisive action will do more to spread the cancer throughout our precious system of independent States and municipalities, than anything else I can think of.

That is why I am tempted to say I would almost rather see a default than an agonizing and interminable period of short term, but inconclusive, "apparent" remedies.

If the solution is to be politically doable and durable, it must be equitable. It should be fundamentally grounded in burden sharing by all—as well as employees and bondholders.

The city must do more, much more, I would say, to reduce its expenses.

The State must do more—assume some of the more anachronistic burdens, generally carried by counties and States in other jurisdictions, which New York City has been forced by tradition to carry.

The Federal Government must do more, not simply to relieve the burden, but to set up a process through which a total long-range and balanced solution can be found.

A word about this process. It is one thing, and most appropriate, for the Federal Government to determine the rigorous standards of financial fitness it will require.

It is quite another, and most inappropriate in my view, for the Federal Government to prescribe the local remedies.

In this same vein, I think it is most appropriate that the Federal Government clear up legal ambiguities or remove unnecessary legislative barriers that stand in the way of New York's elected officials, union officials, and institutions from tailoring the total long-term package approach that New York believes is in its best interest.

And finally, as part of what I would call "universal burden sharing," I believe citizens, workers, and bondholders must all share in the burden.

As part of this solution, it is obvious and essential that the State be the major intermediary between the Federal Government and New York City, and that, to put it bluntly, its financial "tochis is on the tisch," as they say in New York.

First, that the city not only must, but can, do more is self-evident. Some illustrations:

From 1960 to 1975, when the private sector, wealth-producing jobs declined almost 325,000 or 11 percent, public sector jobs increased by about 150,000.

Parkinson's laws so vividly illustrated in the growth of the British Admiralty at a time of a major decline in British naval power, have been confirmed once again in New York.

Second illustration: The fringe benefits of these employees deserve the most serious scrutiny.

It is estimated that the New York City employees' fringe benefits run to nearly 60 percent of their base pay, which is at the least comparable to industry salaries. Yet, industry fringe benefits typically run only about half of that number.

I am talking about vacations, sick leaves, time off, health insurance, noncontributory, and, of course, pensions.

Speaking of pensions, the future costs of the present and unfunded pension benefits more than stagger my imagination. In 1966, these costs amounted to something over \$300 million. By 1974, they had doubled to over \$600 million. And by 1980, they are projected to nearly triple, to roughly \$1.7 billion. In other words, on our present course, present pensions costs alone will increase by something over \$1 billion by 1980.

New York State and New York City—its officials and its unions—should have the option, in my view, of exploring the cruel but necessary tradeoff between fringe benefits, pensions, and jobs!

If they are to have this option, then the Congress will need to revise existing Federal laws, since unilateral State action might make the changes, might raise questions; that is, concerning impairment of existing contracts.

To move to the State: the State of New York can now, without any legislative changes, do more to share some of the more anachronistic burdens of the city. For example, "regionalizing" New York City's tax base, picking up the city's costs for courts and prisons of upward of \$200 million, assuming the city's burden of almost \$300 million per year for the City University, and so forth. These are only some of the possibilities.

The State could temporarily increase taxes—say, sales taxes—to help fund this transitional problem.

The obvious question then, is this: if the city and the State can do all those things to balance its budget, what is the problem?

The problem is simple to state and difficult to solve: the disease of aggravated credibility from years of fiscal irresponsibility will not be cured in the eyes of those who count—the investing public—in time to make the cure possible, even with a balanced budget projection for 1977. There simply is no—and will be no—market for New York securities in the short term.

The Federal role: Any Federal role to provide bridge financing should be accompanied by the most rigorous financial requirements, such as the balanced budget within 3 years: strict adherence to uniform accounting standards—no more gimmicks, no more expense items in capital budgets; next, whatever specific assurances are needed to permit city and State to raise taxes to avoid default; effective monitoring techniques under which expenses, capital expenditures and borrowings are not only carefully controlled, but tough remedies are provided where prior set limits violated (expropriation of Federal revenue sharing funds, discontinuing guarantees et cetera.)

If the Federal Government gets such prior assurances and available remedies, then I believe it should aid in the financing of New York's temporary cash requirements—this aid should apply to New York's needs to roll over its existing short-term debt, as well as meet its new money operating requirements in the approved budgets.

This brings me to another element of burden sharing—the current bondholders of these short-term notes.

I know you have heard from many that nothing can happen to the bondholders.

Let's explore the equity of this. Thousands of jobs of municipal employees have been lost, and thousands more will lose their jobs. Are we saying that it is an immutable fact that in a crisis of this magnitude, thousands of people lose their jobs, but other thousands cannot lose, or be delayed in receiving their interest payments? Particularly when short-term note holders had the potential reward of high and tax-free interest to reward them for their risk.

In another context, risktakers in Franklin National equities and notes and countless other companies, lost everything. Are we saying that municipal note holders only gain and lose or risk nothing?

It is said to "default" in any way—a moratorium on principal or interest, lower interest or what have you—will have malignant effects.

Is this "default" one in solation—that is, where nothing is done to solve the long-term problem—or a default in the context of what I am talking about—that is, a total, long term; packaged settlement?

I would propose that the Federal Government consider legislation, as part of a total and fiscally responsible reorganization, that could require short-term notes maturing currently to be exchange for a new taxable 3-year note guaranteed by the Federal Government, at a rate of interest lower than that on comparable Federal issues.

Beyond the interest payment, the Federal Government should charge the State government a fee that in total would bring the cost of this financing above the normal market cost for current municipal issues.

The reason for this premium or penalty is to encourage the State of New York or any other State to prepay the debt as soon as possible to avoid the extra burden or penalty.

On new funds, the Federal Government would also guarantee the issuance of comparable 3-year notes by New York State at market rates of interest for federally-guaranteed notes, again under the tough guideline alluded to earlier of a total plan of fiscal responsibility.

I believe that a respectable intellectual argument can be made for the fact that such an approach might actually reassure and stabilize the municipal financing market, by removing the enormous uncertainty of the New York situation and by clarifying the very large political and financial costs that any city and State must bear if it is to get those guarantees.

It also keeps New York City out of the tax-exempt market for a period of time.

While many may say it is unthinkable to even explore the concept of recapitalizing any of the existing debt, it is a thought that to me is quite unthinkable in the context of a total plan.

Obviously, such a plan would require new legislation that permits recapitalization of existing debt in carefully prescribed circumstances.

Because our objectives should be to discourage any more of these

cases, I believe we should avoid any new bureaucracies, which would likely become part of the problem instead of the solution and in true Parkinsonian style might feel they had failed, if they did not become the newest bureaucratic growth industry.

As far as the Federal Government is concerned, beyond enabling legislation and guarantees of the type referred to, I believe that Federal Government should explore providing substantive help in such areas as welfare, where unlimited and constitutionally upheld migration of perhaps 1 million people has raised New York's welfare costs to a staggering \$1 billion, six times the amount of just a decade ago. This is a national problem—confirmed by the Supreme Court—not one of New York's making.

Second, explore burden sharing of unusual national or international burdens imposed on New York, such as the 138 foreign embassies and consulates.

Explore whether in this kind of carefully prescribed financial plan and circumstances, the State could be given the option of using Federal funds for certain social purposes to offset some of the deficits, or used for purposes other than those originally legislated.

Again, to provide the largest stimulus to making the guaranteed notes of the shortest possible duration, a major part of those additional federally-provided funds could be earmarked by Federal legislation and be used to accelerate the repayment of those notes and other New York City debts.

This would help break the cycle under which New York City annually pays \$1.6 billion in total unproductive debt service and bring the city eventually to a tolerable debt position.

Many of my examples are simply illustrative. My main point is State and city should tailor approach to meet the standards you have set.

In sum, if we take this opportunity to tailor a tough, disciplined, total package, long-term and burden sharing approach to the New York problem, we might achieve our perennial goal of transferring monumental problems into an unparalleled opportunity.

The CHAIRMAN. Thank you very much, Mr. Peterson.

Mr. Mayer, we don't have a copy, at least I don't have a copy of your statement.

Mr. MAYER. I barely have one myself. Can I just read it quickly?

The CHAIRMAN. Yes, sir.

Mr. MAYER. I became interested in New York City's budget matters when I was chairman of a local school board in New York, and have followed them now for 15 years. While chairman of the local board I made myself iller than I was once by taking the New York City school budget to bed with me. When I came out, I was having lunch at the Bankers' Club and I ran into Jim Donovan, then president of the board of education, and I said I couldn't find where his money went. He said, he had a budget director, a man by the name of Murphy, and the only people in the whole world who knew where the money went were Murphy and God: and when Murphy died, God would know a good deal more than he does now.

I have some different information to bring you.

I think one must know a little history to get some notion of the dimension of the problems and the kind of solution that is possible. I would like to give an example or two.

One of the most interesting ones goes back to 1969, when the government of New York City signed the following four contracts with the unions representing the uniformed services:

(1) A contract with the policemen, specifying that their salary would be at 3 to 3.50 in ratio with the police sergeants—that is, a policeman would receive \$3 for every \$3.50 in a sergeant's pay;

(2) A contract with the firemen, specifying that their salary would be identical with that of the policemen;

(3) And a contract with the fire lieutenants, specifying that their salary would be as 3.90 to 3 in ratio with the firemen—that is, that a fireman would receive \$3 for every \$3.90 paid to a fire lieutenant;

(4) And then there was a contract with the police sergeants, specifying that their salaries would be equal to those of the fire lieutenants.

The policemen thereupon sued for an increase that would bring their salaries back up to the contract ratio of 3 to 3.5 by comparison with the sergeants. This would, of course, have triggered a raise in firemen's salaries under their contract, then a rise in fire lieutenants' salaries under their contract, then a rise in sergeants' salaries under their contract, and then yet another rise for policemen, starting the cycle again. Obviously, the city just couldn't have signed those four incommensurate contracts—but it did, and the policemen's union took the city to the court. By the time we got through the courts in 1971, the courts ruled against the city, despite a claim of non compos mentis, and the city got off the hook only by negotiating another contract.

The lump sum payment for each policeman was \$2,700. The increase in his annual salary immediately was \$1,200. The total cost to the city in back pay to the uniformed services was \$200 million.

Mayor Lindsay told the public it was not to worry, because the State legislature was passing a law that would permit this cost to be capitalized in a new created stabilization reserve fund. That is where \$200 million of our accumulated deficit came from. For that \$200 million I think we can say for sure that compassionate attitudes, or Federal failures to fund programs, or stinginess in Albany had nothing to do with it. It was the incompetency of our elected members and nothing more.

Next: a State law permits the city to take into its general revenues any earnings greater than 4 percent on its pension funds. Our pension funds are calculated on actuarial tables developed in 1910, when fewer people lived to retirement age and retired people lived less long.

We are dramatically underfunded at best. Moreover, the union contracts signed in the 1960's call for very much larger pensions than the city had ever paid before or anybody else is paying now.

Nevertheless, the city this year is taking more than \$80 million out of the pension earnings into its revenues; the accumulated misappropriations—a hidden deficit—from these pension funds are not far off half a billion dollars. In this connection, and with reference to yesterday's "Perils of Pauline" show, it should be noted that Mr. Shanker strongly urged, indeed begged, Governor Carey to veto this year's extension of the law that permits this misappropriation of trust funds.

This is an example of the sort of thing Mayor Beame has said was permitted by State law; and therefore, nobody can blame the city for doing it. There are also, as you now know, as has been pointed out this summer by controller Levitti, hundreds of millions of dollars in accumulated deficit underwritten by paper totally impermissible under

any law—tax anticipation notes for real estate taxes unpaid because they were assessed against tax-exempt property, or even worse, against taxes that, in fact, had already been paid; revenue anticipation notes sold against revenues that the people who certified the figures knew were never going to be received.

One must, in addition, add to any realistic accumulated deficit figure the white elephants funded with city bonds—the West Village Houses, the new \$600 million water tunnel that can be paid out only by water taxes wildly greater than those the city will ever assess, and many, many others.

So we come into the present, then, with an accumulated deficit admitted as \$3.3 billion and really more like \$5 billion and maybe even more if one wrote down to their real value to the people some of the projects now being carried as assets equal to the present value of the bonds that built them. And every year for a while to come we must pay off, out of revenue, expiring bonds against which no sinking funds have been accumulated.

I am here to submit to you that we simply can't do it. The State law passed in September and all the bills now before the Congress are utterly unrealistic because they assume the city of New York can maintain a decent level of vital services with a balance budget that includes a debt service component approaching and then exceeding \$2 billion a year. Let me add that I am simply appalled by the supposedly liberal and compassionate attitude, that one can cut sanitation, and one can cut schools and fire protection, and police protection, and health services—everything can be cut, everything may be sacrificed, except debt service. That is sacrosanct.

Even if we could walk on water this way, even if we could, in fact manage to balance our budget with this fantastic debt service, we would drown within a few years under the flood of money demands from our overpromised and underfunded pension plans.

Beyond the next election, none of the bills now before you would work. When a man tells you he can take \$1 billion, 800 million out of debt service and he is still \$1 billion short, but you should give him a guarantee, I don't see how you can listen to him.

Nothing, nothing can work that pretends that a history of incompetence and fraud is really a history of social concern and bad luck, or that an insolvency problem is really a cash flow problem. We have to face the fact, we are bust. Absent a very large new subsidy from you, which I personally agree with our friends here, you should probably give us, but absent that we must rewrite our contracts with those who lent us money to reduce the interest and stretch out the amortization of our debt, as Mr. Peterson would say, and we must rewrite our contracts with our workers to eliminate the extravagances of the fringe benefits, especially the pensions, we unwisely promised in return for labor peace. Neither of these rewritings can be accomplished by the voluntary process: What we need is something that under present law only a judge in bankruptcy can do.

And let me note that a city under chapter IX, like a business under chapter XI, could gain access to the capital market. A judge could do what MAC tried to do and couldn't, which is establish a class of prior creditors. This could have been done easily in the spring but not now.

Nothing so simple as a chapter IX bankruptcy can now be attempted because the State has made itself the largest creditor of the city and

the State cannot afford any stretching out of the city's repayments. To put the matter bluntly, Governor Carey has successfully blackmailed the Federal Government. But he has paid a high price for it, calling attention to the State's own fiscal weakness.

One way or another, you will beyond question have to permit the State to tap the Treasury for \$2 billion in loans to replace the cash the city cannot repay, and \$3 billion more to enable the payment of State aid to municipalities in the spring.

For the city, the first question, it seems to me, must be the fairest way to share the burden of essentially inescapable bankruptcy. Right now, we have all the disadvantages of bankruptcy in the loss of self-government, but none of the benefits from the scaling down of debt or the restudying of the pension bonanza.

On balance, it seems to me that the people most able to pay are the bankers and rich investors who bought the triply tax-exempt paper—who thought that at 9 percent or more, it could somehow be a safe investment—and the future pensioners, who will be beneficiaries of the greatly enlarged social security payouts. As of now, these are the people who are being asked to pay nothing.

Everything must come out of the workers in the city and the people who live there and need the services.

The word "bankruptcy" seems to be terrifying; let's avoid it. The word "default" is a real threat word. Perhaps instead you could call what you do a municipal restructuring act, with a Federal restructuringer to do what a judge in bankruptcy would otherwise do, under priorities written into the law.

A final point: The city, I fear, is much more fragile than anyone wants to say. Senator Brooke said nobody thinks it is going down the drain. It could.

As a former putative expert on schools—I have written five books on that subject—I received half a dozen calls this summer from people who used to be dedicated New Yorkers, but now wanted to know which suburbs might have the best schools for their kids.

Industrially, we are out of the ballpark—among them, the Southern States, the Japanese, the distant computer mainframes and the Port of Newark have pushed us aside.

Commercially, the carnage in the office buildings become ever more bloody; and the combination of negotiated fees, the computerized central marketplace and the New York transfer taxes will cost us a great deal of Wall Street employment in the next decade.

There is still fat in the city budget—in the fringe benefits, in the shocking management of the Health and Hospitals Corp., in the police officers lounging behind desks and the sanitation workers lounging against their trucks, the school teachers taking their sick leaves on the ski slopes, the city university students paid to attend college, who have been told that a diploma is their inalienable right and are infuriated if they are asked to work for it.

Just this week there was a study. For the first time they apparently did the perfectly commonsense thing of comparing the names of the ages of dependent children rolls—children of school age—with the actual registers in the city's schools. Out of the first 20,000 names they looked at, 3,000 were fraudulent.

But what will in fact be cut to keep paying the 9 percent on the notes are services important to the city.

Living in New York with a wife and two children, I carry a pro rata share of local debt burden that adds up to about \$6,500—all of which I can avoid by crossing the river. My incentives not to cross the river diminish almost daily; my incentives to get out will be dramatically increased by further service cuts.

Frankly, I think the cold bath of a bankruptcy proceeding—the sense that life is being put on a new and rational footing—might revive the city.

But if it looks like New Yorkers will have to carry the burden of our foolish past forever, I think the city can decline very rapidly and rather dully.

The infrastructure is going. We are an old city—our water pipes are bad; the electrical conduits, the bridges are in bad shape; the West Side Highway fell down.

Either give us money which I think really there is a strong case for, or give us the functional equivalent of a feasible chapter IX, but please don't give us the sort of Federal guarantee program that would let us pretend, briefly, that we can pay debts far beyond our means.

That would be even more irresponsible than letting the city painlessly default, and the devil take the hindmost.

Thank you.

The CHAIRMAN. Thank you very much, Mr. Mayer. Both of you gentlemen have certainly given us a lot to think about. Mr. Peterson, your proposal is most unusual, original, and yet it is very appealing. I think you have made a brilliant case for the position you take, but it seems to me that when you come to the bondholders, and I agree with you wholeheartedly from the standpoint of equity, nevertheless, it seems to me you are just avoiding the term "default," which you propose is a default of a kind; is it not? You would require the present security holders to take a longer term instrument, at a lower rate of interest, which is default. Isn't that right?

Mr. PETERSON. Like my colleague here, I assiduously avoided the use of certain words, but certainly the thrust of what I am talking about is usually what happens when you default or recapitalize.

The CHAIRMAN. When you do that, it would have the adverse consequences, on New York, I would think, in coming years. It has required the security holders to take a longer term instrument, low rate of interest, something if they sold it and many perhaps would sell it, which they would have to sell at a very large loss, compared to their purchase price, therefore, wouldn't it be difficult for New York to raise money in the future, for many, many years to come, if it did that?

Mr. PETERSON. I guess as in all things, Senator, the question is, compared to what? As compared to the current situation we find ourselves in, in which the value of these particular short-term notes are already, or should be substantially appreciated, all we are doing in effect is recognizing, by an extension, an implicit loss that either has or should be taken.

As far as the future is concerned, I think it is quite possible, Mr. Chairman, that if you put this in the context that we are now discussing, in which somebody can honestly see that through reduced debt burden, moratorium and these budget reductions we are talking about, I think there is a fair chance that a year or two or three from now the New York market has a chance of stabilizing, whereas under the current alternative, I think it has very little chance of stabilizing.

The CHAIRMAN. If this should happen, if we should follow your lead, would you agree with experts who testified that New York State agencies would be probably in default, too?

Mr. PETERSON. Yes. I think that is probable, right.

The CHAIRMAN. Would it not also be true there may be other cities around the country that would have difficulty raising money? Some might go to default and others would have to pay substantially higher rates of interest.

Mr. PETERSON. I don't think so. I think the problems of other cities and States are remarkably different than ours.

The CHAIRMAN. They are. But does the investor always perceive that? You are an investment banker; isn't it true that many banks who are the principal investors in municipal securities, given this experience in New York, would insist on a lower price and a higher yield?

Mr. PETERSON. Again I have to ask, Mr. Chairman, compared to what?

The CHAIRMAN. Compared to what they do now and over the past 5 years, having had no major defaults for some time.

Mr. PETERSEN. Compared to the current situation, in which there is profound uncertainty about the future of New York municipals, I would argue getting this problem resolved might actually stabilize the market for the other municipal offerings. In fact, that is what I would argue.

The CHAIRMAN. I certainly agree with you wholeheartedly on the need for prompt action. We need to make a decision as swiftly as possible, and on the notion of burden sharing. One other question for you about the Parkinson's law on city employees, with respect to New York. New York isn't unique. We have a very interesting analysis by the Congressional Budget Office which shows that in terms of common municipal functions, New York has substantially less—spends substantially less than San Francisco, Detroit, Newark, and Boston. So this is a national problem. New York's difficulty, it seems to me, comes from a number of things, but one of them is that they had the bad judgment to engage in this short-term financing of their budget deficit, and for that reason I just wonder if we shouldn't try to develop an instrument that bridges that difficulty rather than one that follows the course of precipitating default which could add to adverse effects throughout the country.

Mr. PETERSON. I guess I am probably being a coward in avoiding the use of the word "default," but I would like to say that a default usually implies a rather disorganized, unorganized, out-of-control activity, in which the future is enormously unclear. I am talking about a situation here, in which you authorize the State to make changes to recapitalize the debt that make it possible for them to look at pension contracts, and along with the city and unions, go work out a total plan. I think, if this is not a contradiction in terms, a planned kind of default, in a total context of stability, I think might have very different effects than the kind of quote "default," unquote we are used to.

The CHAIRMAN. Mr. Mayer, I read your very excellent book on banking.

Mr. MAYER. Thank you. You gave me a quote. I used it on the back cover, I think.

The CHAIRMAN. I was delighted with it. I think bankers learned a lot about their business in reading it. I think your presentation this afternoon has been most helpful. It was difficult to follow a presentation as complicated as this without the text.

Mr. MAYER. I will retype it and send it in.

The CHAIRMAN. Thank you. I take it you come down on the side of not the kind of guarantee we have been talking about but on the side of providing either nothing, or providing some kind of an assistance program, which would primarily assure the preservation of essential services in the city, and services such as education and recreation and so forth.

Mr. MAYER. I think I come down very close to Mr. Peterson, actually. I think something that combines a restructuring process with a guarantee is where I come down. You don't have the option of doing nothing. So far as the marketability of municipals is concerned, we can make a major contribution to that in Congress if you eliminate some of the other sources of tax-exempt income from loans and investments you have set up.

One of the reasons for the weakness of the municipal market is the proliferation of instruments in the new tax laws, which enable the banks to purchase things other than municipal paper and get tax-exempt income from them.

You have offered investment tax credits and so forth, where the benefits flow to the banks. There is a whole range of new items you have created which have made the banks much less interested in municipals. My hunch is that the most sensible way to get them interested again would be to look at the tax laws. To say that one can do nothing and the city can go into default with the kind of management it has, that is an unthinkable thing. Where I think the bankers are wrong is that they really do not seem to me to be offering anything. They knew perfectly well about the parity contracts, but they bought the \$200 million worth of notes to finance the deal. They bought repeatedly without finding out whether the revenues were there. They had some obligation to their customers to whom they sold this paper; they can't just say the mayor and comptroller certified it, when everybody in the city knew about the way the city was being run, knew they had one big pot down in the basement of city hall, and they threw money in one side and took it out on the other, and nobody knew where it went.

They had obligations as bankers to their customers to whom they sold the paper. They copped out on that obligation. It really is like Penn Central: when the Fed went to look at First National City to see what the documentation was on the Penn Central loans, they found there wasn't any.

I think some of the price of getting out of our problem has to be paid by them, and I think part of it has to be paid by the people who were greedy and foolish and reached for the 9 and 10 percent, because they were told it was safe. If it were tax exempt and safe, it wouldn't have been offered at that price. It is not wise to encourage people into that sort of foolish misjudgment.

The CHAIRMAN. How about simply getting at the problem by providing a loan to finance the operating deficit in New York? And then letting the security holders cope with the default?

Mr. MAYER. Default is a problem word for me. It is presumably a first step to a bankruptcy procedure. If we talk about bankruptcy as a

composition of indebtedness, we talk about something that is in the normal experience of man. When we start talking about default, we talk really about an Arab that got on an airplane with a gun. It's a threat situation. It is a blackmail situation. I think you have to structure it so they can seek a composition of their indebtedness through bankruptcy procedures which the Constitution—

The CHAIRMAN. That is what I suggested might be done. You, I think most properly, are most concerned about the services, about the employees and fire and school that you have to have if the city is going to continue, provide a loan for that, as an absolutely minimum essential, and then let the default, bankruptcy, whatever you want to call it, take care of the rest of it.

I am not proposing it. I am wondering how you would react to it.

Mr. MAYER. I would react very well except give us our statement and our real situation; give us a grant, not a loan.

The CHAIRMAN. Give us a grant, not a loan? Good luck!

Mr. MAYER. I understand your problems in the Congress, I think, but what I do feel over the long run is so dangerous is to pretend you are giving a loan that is going to be paid back when everybody knows it isn't going to be paid back. People talk about confidence in government.

Sure, you can print money, so you can pretend, but I don't think in the long run it is good for the country.

The CHAIRMAN. You may be right. Many people would say increased revenue sharing for New York City. We can't do that. No way. We have to do something else, and I think, conceivably, a long-term loan, properly administered and given the right kind of priorities and protection conceivably could be paid off, provided, of course, we take other steps, which Senator Eagleton, Senator Javits spoke to before; that is, the federalization of welfare, easing the costs that now burden New York.

Mr. MAYER. Some of that really must be done, but it doesn't get us out of our accumulated problem, I'm afraid. You are talking about \$1.8 billion this year. You are talking about a figure that goes above \$2 billion fairly soon and you are talking about a pension system. In the most recent analysis the State authorities said you have to start putting in \$300 million more a year including this year now over. At 6 percent, \$300 million becomes \$2.4 billion in 36 years. Our pension costs will mount very rapidly in the years ahead because we're not funding this now.

The CHAIRMAN. If I have learned nothing else in these hearings, and I think I have learned quite a bit, it seems the pensions are out of line. There will have to be something to change that.

I think pensions, frankly, I think they are a great thing. I think if somebody has worked a lifetime as a sanitation man picking up garbage, he deserves a pension maybe as high as a U.S. Senator gets, but we can't afford it.

Mr. MAYER. There is a difference between a reasonable pension and what New York has signed off on. Plus, of course, since you are increasing social security benefits, it may be that a reasonable pension is not quite as large as what is in those contracts, even if the contracts are cut down.

The CHAIRMAN. My time is up.

Senator EAGLETON. I was going to say, "You are no damn fool. You are one of the most articulate witnesses I have been privileged to hear." I am glad you brought up that chapter 9 situation because that has been obscured.

It seems to me that Congress must do something about chapter 9. Maybe some city might have to use it—perhaps Detroit or some other city. The actuarial situation is totally outmoded, the underfunding is self-evident, and maybe a year from tomorrow the next crisis will be the bankruptcy of the system's pension.

So, your testimony is very intriguing. I want a written copy of it, too.

The CHAIRMAN. You ought to read his book, too.

Senator JAVITS. If I may have a minute, because I have to run for a plane.

Mr. Peterson, one thing that interested me deeply about what you said or implied, is that some revisions in bankruptcy procedures are necessary. What would happen if those sanitation checks were cut off yesterday is pretty scary. I don't think there is any need for the city of New York to run those risks.

Therefore, would it not be entirely consistent with your approach—it is a drastic one, a drastic one is needed, and nothing should be sacrosanct in this whole situation—to find a way to give the city the breathing space, which looks like June 30, so that it is possible to install what is needed?

The other question I would ask. Don't we have to find a way to give this short breathing space, even though we know it is wasteful but to try to find a way to find that in order to give us the chance to do the very drastic things you are both talking about?

Mr. PETERSON. I couldn't agree with you more, Senaotr. The reason I am proposing a combination of a guarantee with tough discipline and legislative changes that permit restructuring of both the debt and the fringe benefits and pensions is that I think it is going to take the combination of those two things ultimately to give the Sate and city the clear legal option to formulate that kind of approach.

I couldn't agree more with you. That is not gong to be done overnight, so I would put the two in tandem.

Mr. MAYER. Yes: very tough discipline bothers me a little, Senator, because there are places where the city should be reined in. but we are talking now of cuts, many of which are not simply discipline. They are harmful to the people who live in the city who really are mostly innocent victims in this thing.

Some degree of supervision which includes the right to change certain contracted provisions, I think, is necessary for these disciplines to be taken without harm being done to the people.

What is going to be done is to cut our services. What the mayor began to do—I imagine it will be somewhat more harshly done by the State Control Board on Tuesday—is more of that. It seems to me that maintaining the livability of the city means maintaining the services we need.

One of the reasons for our disaster is a while range of legal constraints and a whole range of payments that have to be made for things which are less crucial for the city. In setting this up, you must give the city, it doesn't have to be called a bankruptcy, but must give the city a

chance to wipe away a great inherited burden not only of money, but of habit, custom and law, which will keep it from getting on its feet. The city is going to have a tough time at best in the next year, but we cannot simply pretend that the problem is only that this year it ran out of money, which is what has been going on. Its problems are very deep and must be worked on seriously and money is only one part of it and, therefore, I would like to see something more than that done.

Senator JAVITS. Wouldn't you both agree with me, and I think with my colleague, that the Federal Government has plenty of the same things you have just given us a list of horrors on in many ways and more, but fortunately, it isn't going broke?

Mr. MAYER. It can't.

Senator JAVITS. I agree with you. A touch of humanity right now by the Congress and the State is very, very urgently needed.

Mr. PETERSON. Senator, I wonder if I can say this about this tough tradeoff. I don't think we should for a moment forget that the mayor and Governor and others have already taken significant steps on reducing employment by 31,000 people and another quite a few thousand in the next few weeks.

I would think that it could be argued that giving the city and the unions the option to review these extraordinary costs in the pension plan and consider what I would consider to be a humane tradeoff between reducing those pensions and increasing the jobs is the kind of thing that would give the city some time to adjust to something that has been 20 years in the making.

I think it could be argued that that option, which incidentally I don't think you should legislate in the sense of insisting upon it, but simply give them the option to make that tradeoff, will end up with the unions and the city perhaps arriving at that kind of a compromise peacefully.

Whereas if they don't have that option, and if we go the default route, Mr. Chairman, what concerns me, is with 350,000 thereabouts municipal employees not getting paid, with strikes and violence and all that sort of thing being the main basis on which these things are negotiated, I think that would be a most costly solution, not to mention the human and other considerations.

The CHAIRMAN. It is regrettable that two of the most articulate and thoughtful and intelligent witnesses come at the end when most of the press is not here and other members. But I would to thank you very much.

The hearings are adjourned. The committee will meet to mark up the bill on Tuesday.

[Whereupon, at 5:25 p.m., the hearing was adjourned.]



# NEW YORK CITY FINANCIAL CRISIS

THURSDAY, OCTOBER 23, 1975

U.S. SENATE,  
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS,  
*Washington, D.C.*

The committee met at 2:15 p.m., pursuant to call, in room 5302, Dirksen Senate Office Building, Senator William Proxmire, chairman of the committee, presiding.

Present: Senators Proxmire, Williams, McIntyre, Cranston, Stevenson, Biden, Morgan, Tower, Brooke, Packwood, Helms, and Garn.

Also present: Senators Thomas F. Eagleton and Jacob K. Javits.

The CHAIRMAN. The committee will come to order. Before I introduce our distinguished panel of experts at the hearing this afternoon, I would like to read a new item that has just come to my attention, because I think it is appropriate and ironic.

## THE ZAIRE BAILOUT

The central African country of Zaire may default on loans to New York banks, and the Ford administration plans tomorrow to propose a bailout.

## BACKGROUND

Zaire is suffering from a short run credit crunch, partly because of mismanagement, partly because of a drop in the price of their principal export, copper. Tomorrow, in testimony before Senate Foreign Relations Committee, Deputy Assistant Secretary of State Mulcahy will propose a bailout package. At the moment Zaire is behind on about \$10 million in short and medium term loans to New York banks. Although there is no official default yet, the arrearage is expected to grow, and Zaire has in effect defaulted.

The State Department proposes a \$60 million package, including a \$20 million soft loan to restructure Zaire's debt. Terms are expected to be 25 years, 5 percent, with at least a 5-year grace period on repayment. Package also includes Eximbank credits, commodity assistance and IMF stabilization plan. The \$20 million loan, through AID, will be a budget item.

Question: If Zaire, why not New York?

Obviously that has some relevance to what we are meeting about today.

Senator TOWER. May I ask the chairman what is the relevance?

The CHAIRMAN. The Senator from Texas wants to know the relevance? Well, "If Zaire, why not New York?"

I understand that New York is part of this country, a city and a State and has been for years.

[Laughter.]

Senator MORGAN. But I might say two wrongs don't make a right.

The CHAIRMAN. The Senator is certainly right—

Senator TOWER. I don't recall having endorsed the Zaire bailout. What does that have to do with this committee?

(721)

The CHAIRMAN. It may or may not have something to do with this committee. I presume the Foreign Relations Committee will handle that. Whether or not the Senate supports this would be interesting to see.

We have had previous bailouts of other countries in the past, in the recent past, that have been much more substantial than this. This seems to me is an apt and timely reminder of the irony in the way this Government of ours and the administration operates. The administration is proposing it.

Senator GARN. Has Zaire been as irresponsible as New York?

The CHAIRMAN. Perhaps that is debatable. However, Zaire has been irresponsible to a considerable extent. All of the evidence is there has been considerable mismanagement involved.

Senator TOWER. Mr. Chairman, I think we ought to avoid trying to politicize this thing. I have not made one referencing to the administration's position on this, or the nature of the support or opposition. Obviously New York has some bipartisan support and bipartisan opposition.

The CHAIRMAN. I honestly hope we get some bipartisan voting on this committee, and bipartisan participation in these considerations.

So far, unfortunately, we have had a partisan split, recognizing, of course, the minority—

Senator TOWER. Are you drumming Senator Morgan out of the loge?

The CHAIRMAN. Well, no, Senator Morgan, we are certain he is likely to vote with us; we hope in the future. He is an open-minded Senator. But I am recognizing the fact we didn't get one single vote in support or indication of support from the minority members of this committee. We hope that is going to change. I think maybe it will, if the facts warrant it.

Senator TOWER. I would point out that that was on one specific proposed solution to the problem. It was not on the issue or the question of whether or not we should do something or do nothing.

The CHAIRMAN. Well, I am sure the committee and the Congress is going to do something.

Senator TOWER. I think the high probability is we will. The question is what is the right thing to do.

The CHAIRMAN. All right. Unless somebody else wants to make a statement, we will proceed with the hearing.

The purpose of the hearing is to question the witnesses.

Senator TOWER. I understand that, but I didn't make the first statement.

The CHAIRMAN. The distinguished Senator is correct, the chairman made the first statement.

The panel consists of Mr. Arthur Levitt, comptroller, State of New York; Harrison Goldin, comptroller, city of New York; Simon H. Rifkind, who is an expert in bankruptcy and also, as I understand it, was the chief clerk of this committee a few years ago, in 1931.

Mr. RIFKIND. I think so.

The CHAIRMAN. We also have Mr. Axelson, and Mr. Lewis. Is Mr. Axelson present?

Will you come to the table, Mr. Axelson?

**STATEMENT OF ARTHUR LEVITT, COMPTROLLER, STATE OF NEW YORK; HARRISON J. GOLDIN, COMPTROLLER, CITY OF NEW YORK; KENNETH S. AXELSON, DEPUTY MAYOR FOR FINANCE, CITY OF NEW YORK; AND SIMON H. FIFKIND**

The CHAIRMAN. Now, gentlemen, you were invited to appear and I understand you may or may not have statements you would like to make before we proceed to question you.

If you have statements, we would be very happy to hear them.

Mr. Levitt, do you have a statement you would like to make?

Mr. LEVITT. Yes, sir, very briefly, if I may.

The CHAIRMAN. Very good. Go right ahead.

Mr. LEVITT. Mr. Chairman, my name is Arthur Levitt, and I am the 50th comptroller of the State of New York, and I am in my sixth term of office. I trace my title back to Sam Jones, of Oyster Bay, who took office as the first comptroller in 1797.

The comptrollership in the State of New York is a completely non-partisan office. It deals with money, figures audits, performance, and financial audits and has been widely recognized throughout the State, if not throughout the country, as an office entirely professional, free from partisan political bias.

Among the important responsibilities I bear is that of supervising the fiscal and financial affairs of some 7,000 units of government scattered throughout the State, from the largest city to the smallest district, special district, school district.

For this purpose we maintain and have for years maintained a corps of trained auditors who go about the State and perform the so-called performance audit and financial audit, which are then filed, after conference with the audited agency, for the information of the general public.

Since 1971 my office acquired the responsibility of auditing the affairs of New York City, Buffalo, and Rochester. Prior to that date we were not permitted to audit them. Our audit authority did not extend to those three cities.

The events of the past few weeks have made it increasingly clear that, without Federal intervention, New York City will default on its obligations and will be unable to meet its day-to-day expenditures some time in December.

Similarly, several State-created public authorities, responsible for financing major construction programs, will default some time in November or December. Further, the State and its other municipalities have virtually lost access to the capital markets.

Every day I get a call from a school district, or a group, lamenting the fact that their access to the market is conditioned only by the huge, unbelievably high interest rates.

Two basic facts need to be recognized; one, the cash flow of the city, the amounts needed to finance the city's opening deficit, its capital construction program, its maturing short- and long-term borrowings are simply too great, utterly and completely beyond its means.

Neither the city nor MAC have access to the capital markets, and the State of New York has already greatly overextended itself in an effort to salvage the affairs of the city of New York.

Despite the inherent financial strength of the State, the several State-created public authorities, and the State's other municipalities, we simply no longer have access, as of today, to the capital market.

Between now and June 30, 1976, New York State, New York City, the State's public authorities, and the State's other municipalities will need to borrow about \$13 billion.

New York City requires \$5 billion. New York State needs over \$4 billion.

The State's public authorities need another \$2 billion.

The State's other municipalities need \$2 billion.

And as appears likely from reports of the members of the legislature and others the State will run a sizable deficit this year, and that deficit must be added to these borrowings, since I will be faced with the necessity of financing them through additional borrowing.

I am furnishing this committee with a month-by-month schedule of these needs. I want to assure you that these estimates are conservative. The State has done all in its power to shore up the financial condition of New York City, and of several State public authorities of the so-called moral obligation type.

The State came to the aid of the urban development corporation with \$200 million in appropriations early in the year. It advanced some \$900 million to New York City between April and August against State aid payments due later in the year.

It recently put together a \$2 billion package of assistance to the city, much of which required borrowings by the State itself. It has shored up the dormitory authority and other agencies through various commitments and recently put together a \$90 million package of loans to meet the short-term obligations of the housing finance agency, the most viable of all of the so-called special agencies of the State government itself.

The State can do no more without placing its own financial condition in serious jeopardy, if indeed it is not already in serious jeopardy.

It is obvious that the fate of the State is linked to the capital situation affecting New York City and the State's public authorities. The State is already paying a heavy price, as evidenced by interest rates on recent short-term State borrowings and by the inability of the State to gain access to the capital markets on borrowings intended to aid the city.

Let me tell the committee about a recent experience I had in this regard. The State, by reason of a legislative appropriation, was called upon this month to advance to the city of New York \$250 million on a so-called first instance appropriation by the legislature.

This means the money is given to the city in the first instance as a loan from the State. And the city is expected to repay that within 1 year our constitutional requirement.

Normally I would go to the banks and borrow this money, since we don't have this amount of cash on hand. But this time the banks refused to lend any amount to the State, not to the city. This was a loan to the State from the big commercial banks in the city of New York that I was asking for, so that the State might fulfill the legislative appropriation of \$250 million.

The CHAIRMAN. What was the date of this?

Mr. LEVITT. October 7 or 8. Just a short time ago. Faced with that dilemma, a dilemma which as far as I know is the first occurrence of its kind in the history of the State, I made the decision to lend the money to the State government on the part of the State employees' retirements system, of which I am the sole trustee.

Here we had obligation secured in the first instance by the full faith and credit of the State of New York, a 1-year obligation, secured always according to the terms of the statute by the city's complete portfolio of Mitchell-Lama mortgages amounting in capital to over a billion dollars, and secured, finally, by the State's commitment to extend aid to the city in the amount of \$2½ billion.

As the State comptroller, I control these funds, and hence the provision was for me to deduct these amounts from the city's State aid, as and when it was payable to the city.

I undertook to make that advance on behalf of the State employees retirement system at an interest rate of 8⅞, which I arrived at through consultation with various experts in the field, soliciting the advice and opinions of the city comptroller, and director of the budget of the State.

Having done this, I approached the commercial banks, the big commercial banks of the city, and I said to them, see here, gentlemen—addressing the chief operating officer of each bank—I have the money, the \$250 million, which the State is required to advance to the city of New York, I don't need your money, but the State urgently needs a demonstration of your confidence in the future of the State.

Hence, won't you please take a modest participation in this note issue.

And they said, what do you call a modest participation.

I said, well, it seems to me if you took \$50 million, that would be a reasonable participation. I don't need it, but this would show that you, the big commercial banks in the city of the New York, have faith and confidence in the State's future.

And I finally got down to begging for \$10 million, Mr. Chairman, and didn't get that. So I made the whole advance, and I am glad that I did it.

The retirement system has a generously secured loan of \$250 million, short-term, and the State of New York was able to fulfill the legislative mandate to advance that amount of money to the city of New York.

In November, the Housing Finance Agency will need \$131 million just to finance its maturing short-term debt. In December, the HFA will need another \$143 million. But the HFA has no access to the capital markets.

Mr. Chairman and gentlemen, the State seeks neither Federal grants nor Federal loans. We can pay our own way, but we do have, as you observe, a serious cash flow shortage brought about by our inability to gain access to the capital markets, and what we need is a guarantee of our obligations without any risk, as I see it, to the guarantor.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Levit.

Mr. GOLDIN?

Mr. GOLDIN. Mr. Chairman, I understand that there are certain specific questions to which members of the committee might like me to

address myself, so if you will permit me, I would like to read a statement in which I undertake to deal with them and then, of course, I will answer questions.

I would like to introduce my special deputy for financial planning, Stephen Clifford.

I am Harrison J. Goldin. I am the comptroller of New York City. I have served in this capacity since January 1, 1974.

I also served as a member of the State Emergency Financial Control Board for New York City.

For the committee's information, the New York City Comptroller is an elected official with a variety of fiscal responsibilities under the city charter, including auditing and accounting, but not including budget management or tax collection, which are performed by agencies responsible to the mayor.

The comptroller is also among a number of trustees of the city's five pension systems, and his office is the designated agent of the trustees in managing the investment of most city pension funds.

Key policy decisions concerning investments are made by vote of the trustees with the advice of professional investment managers.

The comptroller is the sole trustee of the city's sinking funds.

For many years, mayors have delegated to comptrollers the authority to do the city's borrowing, and the comptroller has been responsible for anticipating the city's cash needs and for insuring that sufficient funds are on hand to meet obligations.

As required under the city charter, I have on a number of occasions during my 22 months in office issued advisory reports on various aspects of the city's fiscal affairs. These reports have invariably warned of the rising burden of debt.

I also commissioned verifications by independent certified public accounting firms of certain city accounts. When publicly released in the summer of 1974, these verifications disclosed deficiencies in the city's bookkeeping and records, and noted that such deficiencies made it difficult if not impossible to effect reconciliations and generate reliable data.

I review these events to offer a partial explanation for the difficulty which the city has sometimes encountered in providing certain detailed data which might be thought to be readily available.

Although improvements have been made and continue to be made, there has not been sufficient time, especially in the face of budgetary pressures, to remedy all the problems of which we became aware.

I understand that the committee wishes to obtain at this time the most complete and most recent information available on:

(1) The city's cash needs for the remainder of the current fiscal year and for future fiscal years;

(2) The implications of a possible default on our city's cash flow and essential service needs; and

(3) The balances and assets in funds and accounts maintained by the city and by its authorities and public benefit corporations.

I will be glad to summarize this information and will supply additional data on request, including our annual report for the last year and the page proofs and printers' proofs of our annual report for the year just ended.

The city's need for cash over and above its ordinary revenues is caused by four principal factors:

(1) The obligation to redeem maturing notes at a time when re-financing in the public credit markets is not possible;

(2) The obligation to pay for construction, maintenance and other costs incurred under the capital budget at a time when the ordinary capital funding process, the issuance of bonds, cannot be accomplished;

(3) The existence of a deficit in the current-year budget which, although scheduled to be eliminated by 1977-78, will still create a cash gap of diminishing size until fully eliminated;

(4) The seasonal imbalances in cash flow which are ordinarily evened out by borrowing against current-year receivables.

There has been some misunderstandings of the city's cash needs arising from a failure to comprehend fully all four elements, their impact, and their interrelation.

Capital spending, for example, is additional to the spending provided for in the city's expense, or operating budget.

Now that capital spending cannot be funded through bonds—because of the closing of the credit markets—the city must pay capital costs already incurred, or necessary to be incurred, out of whatever revenues are in hand, despite the fact that such revenues were never calculated or designed to cover capital spending.

Significant, in this connection, are the expense-type items which now comprise approximately half—in dollar volume—of all the items for which the city was scheduled to borrow under its capital budget.

Although these items are now required to be phased out of the capital budget under State law, they will continue, until the phaseout is completed, to require payment out of general revenue sources as long as the public credit markets are closed to the city.

Similarly, the concentration of attention on the kind of short-term borrowing which had the effect of papering over deficits in past years has obscured the fact that a certain amount of borrowing is necessary and unavoidable for the simple and legitimate purpose of evening out cash flow during the course of the year.

For example, to state the obvious as an illustration, a budget balanced on an aggregate 12-month basis would not in itself prevent default if in a particular month or a particular quarter the fixed obligations greatly exceeded the cash receipts for the same period.

With this as background, projections of the city's cash needs for the period of October 1, 1975 to June 30, 1976, the end of our fiscal year—are as follows:

Operating expenses, reduced in accordance with the latest plan developed by the mayor and approved with modifications by the State emergency financial control board, are \$7,387 billion.

Capital budget spending is projected at \$1.147 billion and the combination of debt service and short-term rollovers at \$4.6 billion.

The \$4.6 billion includes nearly \$3 billion in short-term debt maturities together with \$1.7 billion in interest, redemption, and the MAC takeout from what would otherwise be city revenues.

The total of these expenditures requirements for this is \$13.1 billion.

Revenues for this period are projected at \$8.4 billion, resulting in a cash need of \$4 billion.

The obligation to pay this year a note held by the State of New York brings the total cash need to \$4.8 billion.

The fact that the total cash need for the 9-month period roughly approximates the debt service for the period has understandably led to some speculation that the city's fiscal crisis would not exist if there were a moratorium on all debt service.

But this overlooks several critical factors. It overlooks the serious seasonal cash flow imbalances which I discussed earlier.

The next projections represent the cash condition of the city if no debt service at all were to be paid by the city.

The month of December 1975 alone would see a short-fall, or cash need, of \$389 million.

The month of January would produce a shortfall, or cash need, or \$329 million.

In February the city would be short \$122 million, and in March, \$380 million.

I repeat that these shortfalls would exist even if not a penny of debt-service—interest or principal—were to be paid.

In these 4 months the city would be short a total of \$1.2 billion dollars for the delivery of essential services.

Assuming that the city were in default on its debt service, it becomes impossible to conceive of a source for such a sum.

Lacking a means to meet the cash need in December, the city would have to cut the budget sufficiently to effect a \$389 million savings in December alone, which would offset a cash shortfall of that amount in December and offset shortfalls in the following 3 months if continued in force.

On an annualized basis the cuts would constitute a \$4.7 billion slash in combined capital and expense spending.

Since a moratorium, or default, on debt service is unprecedented in New York City, or certainly on this scale anywhere in the country, it is impossible to predict the full range of consequences.

One consequence, perhaps not heretofore brought to the attention of the committee, would be a sharp reduction in the amount of real estate taxes that the city could constitutionally levy and, therefore, a very sharp reduction in even the projected range of revenues under schedules which are not predicated on a possible default.

This is because the city's real estate taxing authority under the State constitution derives partly from the use of real estate taxes to pay long-term debt service.

Once the city failed to use its real estate taxes for this purposes, aftermath of a default, approximately 43 percent of its tax levy—or some \$1.4 billion a year could no longer be imposed or collected.

Even if through some turn of events a court should allow the city to tax real estate at current rates following default, the fact of the default and the consequent inability of the city to issue debt would reduce anticipated real estate revenues in the next fiscal year in any event by approximately \$400 million.

To recapitulate, the city needs \$4.8 billion for the full period between October and June, of which \$1.1 billion is being provided by MAC. This leaves \$3.9 billion to be raised for the period December to June, in order to avoid default.

If default takes place on debt service alone, the city still needs to raise \$1.6 billion from October through March—or \$1.2 billion from December through March—in order to pay remaining expenses.

The period following March is clouded until June by the uncertainty of real estate tax collections if default occurs.

The problem, however, does not end with the city's current fiscal year.

Looking toward 1976-77, and assuming further reductions in the expense and capital budgets in accordance with the recently adopted 3-year fiscal plan, the city's total cash needs over and above its revenues can be projected at \$5.8 billion.

This total includes \$4.2 billion in short-term debt rollovers, \$1.100 billion in capital budget spending and a diminished deficit of \$470 million in the operating or expense budget after providing for \$1.6 billion in interest and redemptions and approximately \$600 million for the MAC takeout.

For those of you who are doing the arithmetic I would note for your convenience I have rounded out the numbers.

If there were no debt service paid by the city through 1976-77, the overall cash needs in that year alone would be \$1.4 billion, with a peak midyear need even higher because of seasonal cash flow imbalance.

These projections will naturally raise a question as to how New York City can emerge from its cash crisis even if some means is provided to see it through 1976-77, 1977-78, and possibly beyond.

The answer may be found by looking behind the numbers at what is already happening, and what will continue to happen, with respect to the city's accumulated prior-year deficits, its current deficits, and its overall debt position.

As it entered its current fiscal year the city was confronted with accumulated prior year deficits of \$2.6 billion plus a current deficit on an operating basis of \$1.0 billion, for a total of \$3.6 billion.

By December 1 of this year, when the financing arranged by the Municipal Assistance Corp. runs out, the city through MAC will be then have funded \$3.2 billion of this enormous deficit.

When it enters the next fiscal year, 1976-77, the city will carryover \$500 million of the old deficit plus a current deficit of \$400 million for a total of \$900 million; a large sum to be sure, but still less than 30 percent of the total combined deficit 1 year earlier.

The following year will see adoption of a budget genuinely balanced on a cash basis.

Well before then, the city will have completed the installation, as required by State law, of a reformed accounting system in conformity with the standards of the State comptroller and the Municipal Finance Officers Association.

Furthermore, the city will be functioning, as it is today, under a State-imposed statutory ceiling on the amount of short-term debt it may have outstanding.

By the end of 1977-78 the city will have paid off approximately \$400 million of the money which has been raised by the Municipal Assistance Corp. this year to fund and begin to close out the accumulated deficits.

No one can say for certain, but given these conditions, and assuming that default will have been avoided, it is reasonable to expect that

the city can begin on a small and gradual basis to issue long-term debt to fund its capital expenditures.

We all know it is true that investors act on emotion as well as logic, and the fact of fiscal reform, when accomplished, combined with avoidance of default, may surely not promptly readmit New York to the capital markets.

But we know that default, if it occurs, will seal the markets to New York for an inevitably long period, thus prolonging our dependency; will lose for us, probably forever, entire classes of investors who would never touch a debt instrument flawed by default; will further erode our economy as business firms flee the hazards and uncertainties of a bankrupt city with no hope for recovery; will probably trigger the default of New York State; and, beyond this, will have national and international consequences which none of us can clearly foresee.

As a second piece of information, I understand that the committee wishes a report on the percentages of city spending in certain categories, exclusive of debt service.

The city's budget for 1976-77 will be expended approximately as follows:

Payroll, direct will be 39.5 percent of total.

Payroll, indirect, payments to independent agencies will be 3.5 percent of total.

Public assistance, 12.1 percent of total.

Medicaid—including portion paid to health and hospitals corporation—4.6 percent paid to health and hospitals corporation—will be 14.1 percent of total.

Other welfare grants, charitable institutions, 8.6 percent of total.

Pensions, social security fringes, 12.2 percent of total.

Vendors, contractors, 10 percent of total.

Now, capital spending, payroll, 30 percent of total; vendors, contractors, 70 percent of total.

A mayoral committee of default has drafted a contingency plan calling for an order of priority in seeking to maintain vital services in the event of default.

As indicated earlier, even the total omission of debt service payments would require substantial cuts in other categories of expenditure, assuming that the New York State constitution permitted such abrogation of obligations to holders of our notes and bonds.

Should it be established that the concepts of general obligation and full faith and credit do not mean what generations of investors have believed they mean, the consequences would be far reaching for municipal borrowers and the Nation's credit markets.

I understand, finally, that certain members of the committee might also be interested in information respecting assets, cash on hand, and related assets, either under the jurisdiction of the committee, or under the control or jurisdiction of affiliated corporations or agencies. I will now undertake to provide that information in summary form.

As of yesterday, the city had a book balance in its general entry accounts of \$72 million. Since we invest through a sophisticated pool and satellite system, modeled on other systems presently developed elsewhere in the country, virtually all of our cash float that is potentially available, we had a repurchase agreement with banks to the extent of \$154 million. Meaning, in effect, a negative balance on our books of

\$82 million, because of our aggressive cash management and investment program. Covered organizations around the city, to the best of our knowledge, because most of them are not accountable to the city directly or its comptroller, had aggregate cash on hand in various categories of accounts of some \$275 million, although I would want to point out very quickly that large segments of that relate to commitments respecting the amortization and retirement of the debt of those covered organizations.

Our pension fund, as you know, the total assets in our pension fund aggregate some \$7.5 billion. We have already invested or will by the end of November, upward of 15 percent of the total assets of those pension systems, in obligations of the city of New York directly or of its municipal assistance corporation, some \$1,300 million. It is a judgment that, even if we were to liquidate completely the assets in those portfolios, passing for the moment the question of the prudence of so doing, given the city's contractual commitment, and the recent legislative enactment of this Congress respecting private pension systems, even assuming that the independent trustees were to vote such liquidation, even assuming that the market would in a relatively brief period be able to absorb such assets, if all of that were to happen, liquidation could yield perhaps \$3 billion from corporate fixed income obligations, perhaps \$1 billion from common stocks, and perhaps as much as \$500 million from other miscellaneous obligations for a total of \$4½ billion. I would point out that given what I remarked earlier about our projections of our cash flow requirements next year, this would still be insufficient to enable us to meet our demands, assuming total investment in city or city-related securities, and we would still have to default.

Lastly, Mr. Chairman and members of the committee, I am the sole trustee of city sinking funds. They have assets of some \$940 million, just under \$1 billion. By the end of November all of these assets will have been invested in city obligations or city-related obligations save for some \$33 million in cash, which we are not permitted by law to invest in that fashion. Since last December alone, we have bought \$380 million in city and MAC securities. And I secured changes in the laws on two occasions from the State legislature to enable us to invest the maximum in city or city-related securities.

I am glad to answer your questions.

[The complete statements of Mr. Levitt and Mr. Goldin follow:]

STATEMENT OF ARTHUR LEVITT, COMPTROLLER, STATE OF NEW YORK

Mr. Chairman: The events of the past few weeks have made it increasingly clear that, without Federal intervention, New York City will default on its obligations and will be unable to meet its day-to-day expenditures some time in December. Similarly, several State-created public authorities, responsible for financing major construction programs, will default some time in November or December. Further, the State and its other municipalities have virtually lost access to the capital markets.

Two basic facts must be recognized:

a. The cash flow needs of the City—the amounts needed to finance the City's operating deficit, its capital construction program, and its maturing short and long term borrowings—are simply too great. Neither the City nor MAC have access to the capital markets, and the State of New York has already overextended itself.

b. Despite the inherent financial strength of the State, the several State-created public authorities, and the State's other municipalities, we simply no longer have access to the capital markets.

Between now and June 30, 1976, New York State, New York City, the State's public authorities and the State's other municipalities will need to borrow about \$13 billion :

New York City needs \$5 billion.

New York State needs \$4 billion.

The State's public authorities need \$2 billion.

The State's other municipalities need \$2 billion.

I am furnishing you with month-by-month schedules of these needs. These estimates are conservative.

The State has done all it can to shore up the financial condition of New York City and several State public authorities of the so-called "moral obligation" type. The State came to the aid of the Urban Development Corporation with \$200 million in appropriations early in the year. It advanced some \$900 million to New York City between April and August against State aid payments due later in the year. It recently put together a \$2 billion package of assistance to the City, much of which will require borrowings by the State itself. It has shored up the Dormitory Authority and other communities through various commitments. It recently put together a \$90 million package of loans to meet maturing short-term obligations of the Housing Finance Agency. It can do no more without placing its own financial condition in serious jeopardy.

It is obvious that the fate of the State is closely linked to the capital situation affecting New York City and the State's public authorities. The State is already paying a heavy price, as evidenced by interest rates on recent short-term State borrowings and by the inability of the State to gain access to the capital market on borrowings intended to aid the City. Furthermore, if the public authorities should default on their notes, the investment community will look upon such a default as a weakness of the State itself, even though the authorities are "moral obligation" agencies.

The other municipalities are also paying a heavy price for the difficulties faced by New York City. To the extent that municipalities have been able to borrow at all, their interest rates have been extraordinarily high.

To give you a further idea of the seriousness of the financial crisis, let me cite a few more facts :

As a result of the financing package put together by the State, the City will be able to finance its needs through November. In December, however, the City will have expenditures of \$1.5 billion. But its anticipated revenues are only \$600 million.

In November, the Housing Finance Agency needs \$131 million just to finance its maturing short-term debt. In December, the HFA will need another \$143 million. But the HFA has no access to the capital markets.

Mr. Chairman, the State of New York seeks neither Federal grants nor Federal loans. We can pay our own way. But we have a serious cash flow shortage brought on by our inability to gain access to the capital markets. We need you to guarantee our obligations.

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STATEMENT OF HARRISON J. GOLDIN, COMPTROLLER, CITY OF NEW YORK

Mr. Chairman and distinguished Members of the Committee: My name is Harrison J. Goldin. I am the Comptroller of the City of New York. I have served in this capacity since January 1, 1974. I also serve as a member of the State Emergency Financial Control Board for New York City.

For the Committee's information, the New York City Comptroller is an elected official with a variety of fiscal responsibilities under the City Charter, including auditing and accounting but not including budget management or tax collection, which are performed by agencies responsible to the Mayor.

The Comptroller is also one among a number of trustees of the City's five pension systems, and his Office is the designated agent of the trustees in managing the investment of most City pension funds. Key policy decisions concerning investments are made by vote of the trustees with the advice of professional investment managers. The Comptroller is the sole trustee of the City's Sinking Funds.

For many years, Mayors have delegated to Comptrollers the authority to do the City's borrowing, and the Comptroller has been responsible for anticipating the City's cash needs and for insuring that sufficient funds are on hand to meet obligations.

As required under the City Charter, I have on a number of occasions during my 22 months in office issued advisory reports on various aspects of the City's fiscal affairs. These reports have invariably warned of the rising burden of debt.

I also commissioned verifications by independent Certified Public Accounting firms of certain City accounts. When publicly released in the summer of 1974, these verifications disclosed deficiencies in the City's bookkeeping and records, and noted that such deficiencies made it difficult if not impossible to effect reconciliations and generate reliable data.

I review these events to offer a practical explanation for the difficulty which the City has sometimes encountered in providing certain detailed data which might be thought to be readily available. Although improvements have been made and continue to be made, there has not been sufficient time, especially in the face of budgetary pressures, to remedy all the problems of which we became aware.

I understand that the Committee wishes to obtain at this time the most complete and most recent information available on: (1) the City's cash needs for the remainder of the current fiscal year and for future fiscal years; (2) the implications of a possible default on one City's cash flow and essential service needs; and (3) the balances and assets in funds and accounts maintained by the City and by its authorities and public benefit corporations.

I will summarize this information and will supply additional data on request.

The City's need for cash over and above its ordinary revenues is caused by four principal factors:

- (1) the obligation to redeem maturing notes at a time when refinancing in the public credit markets is not possible;
- (2) the obligation to pay for construction, maintenance and other costs incurred under the capital budget at a time when the ordinary capital funding process, the issuance of bonds, cannot be accomplished;
- (3) the existence of a deficit in the current-year budget which, although scheduled to be eliminated by 1977-1978, will still create a cash gap of diminishing size until fully eliminated;
- (4) the seasonal imbalances in cash flow which are ordinarily evened out by borrowing against current-year receivables.

There has been some misunderstanding of the City's cash needs arising from a failure to comprehend all four elements.

Capital spending, for example, is additional to the spending provided for in the City's expense, or operating budget. Now that capital spending cannot be funded through bonds (because of the closing of the credit markets), the City must pay capital costs already incurred, or necessary to be incurred, out of whatever revenues are in hand, despite the fact that such revenues were never calculated or designed to cover capital spending.

Significant, in this connection, are the expense-type items which now comprise approximately half (in dollar volume) of all the items for which the City was scheduled to borrow under its capital budget. Although these items are now required to be phased out of the capital budget under State law, they will continue, until the phase-out is completed, to require payment out of general revenue sources as long as the public credit markets are closed to the City.

Similarly, the concentration of attention on the kind of short-term borrowing which had the effect of papering over deficits has obscured the fact that a certain amount of borrowing is necessary and unavoidable for the simple and legitimate purpose of evening out cash flow.

To state the obvious as an illustration, a budget balanced on an aggregate 12-month basis would not in itself prevent default if in a particular month or a particular quarter the fixed obligations greatly exceeded the cash receipts for the same period.

With this as background, projections of the City's cash needs for the period of October 1, 1975 to June 30, 1976 are as follows.

Operating expenses, reduced in accordance with the latest plan developed by the Mayor and approved with modifications by the State Emergency Financial Control Board, are \$7.387 billion.

Capital budget spending is projected at \$1.147 billion and the combination of debt service and short-term rollovers at \$4.6 billion. The \$4.6 billion includes nearly three billion in short-term debt maturities together with \$1.7 billion in interest, redemption, and the MAC takeout from what would otherwise be City revenues.

The total of these expenditure requirements is \$13.1 billion.

Revenues for this period are projected at \$8.4 billion, resulting in a cash need of \$4.6 billion. The obligation to pay this year a note held by the State of New York brings the total cash need to \$4.8 billion.

The fact that the total cash need for the nine-month period roughly approximates the *debt service* for the period has understandably led to some speculation

that the City's fiscal crisis would not exist if there were a moratorium on all debt service.

But this overlooks the serious seasonal cash flow imbalances which I discussed earlier.

The next projections represent the cash condition of the City *if no debt service at all were to be paid*. The month of December, 1975, alone, would see a shortfall, or cash need, of \$389 million. The month of January would produce a shortfall, or cash need, of \$329 million. In February, the City would be short \$122 million; and in March, \$380 million.

I repeat that these shortfalls would exist even if not a penny of debt-service—interest or principal—were to be paid.

In these four months, the City would be short a total of \$1.2 billion dollars. Assuming that the City were in default on its debt service, it becomes impossible to conceive of a source for such a sum.

Lacking a means to meet the cash need in December, the City would have to cut the budget sufficiently to effect a \$389 million savings in December alone, which would offset a cash shortfall of that amount in December and offset shortfalls in the following three months if continued in force. On an annualized basis, the cuts would constitute a \$4.7 billion slash in combined capital and expense spending.

Since a moratorium, or default, on debt service is unprecedented in New York City, it is impossible to predict the full range of consequences. One consequence, perhaps not heretofore brought to the attention of the Committee, would be a sharp reduction in the amount of real estate taxes that the City could constitutionally levy.

This is because the City's real estate taxing authority under the State Constitution derives partly from the use of real estate taxes to pay long-term debt service. Once the City failed to use its real estate taxes for this purpose, approximately 43 per cent of its tax levy—or some \$1.4 billion a year—could no longer be imposed or collected.

Even if through some turn of events a court should allow the City to tax real estate at current rates, following default, the fact of the default and the consequent inability of the City to issue capital debt would reduce anticipated real estate revenues in the next fiscal year by approximately \$400 million.

To recapitulate, the City needs \$4.8 billion for the full period between October and June, of which \$1.1 billion is being provided by MAC. This leaves \$3.9 billion to be raised for the period December to June, in order to avoid default.

If default takes place on debt service alone, the City still needs to raise \$1.6 billion from October through March—or \$1.2 billion from December through March—in order to pay remaining expenses. The period following March is clouded by the uncertainty of real estate tax collections if default occurs.

The problem, however, does not end with the City's current fiscal year.

Looking toward 1976–1977, and assuming further reductions in the expense and capital budgets in accordance with the three-year fiscal plan, the City's total cash needs over and above its revenues can be projected at \$5.8 billion.

This total includes \$4.2 billion in short-term debt rollovers, \$1.100 billion in capital budget spending, and a diminished deficit of \$470 million in the Expense Budget after providing for \$1.6 billion in interest and redemptions and approximately \$600 million for the MAC take out.

If there were no debt service paid through 1976–1977, the overall cash needs would be \$1.4 billion with a peak midyear need even higher because of seasonal cash flow imbalance.

These projections will naturally raise a question as to how New York City can emerge from its cash crisis even if some means is provided to see it through 1976–1977, 1977–1978, and possibly beyond.

The answer may be found by looking behind the numbers at what is already happening, and what will continue to happen, with respect to the City's accumulated prior-year deficits, its current deficit, and its debt position.

As it entered its current fiscal year, the City was confronted with accumulated prior year deficits of \$2.6 billion plus a current deficit of \$1.0 billion for a total of \$3.6 billion.

By December 1, when the financing arranged by the Municipal Assistance Corporation runs out, the City through MAC will have funded \$3.2 billion of this enormous deficit.

When it enters the next fiscal year, 1976–1977, it will carry over \$500 million of the old deficit plus a current deficit of \$400 million for a total of \$900 million—a large sum but still less than 30 per cent of the total combined deficit one year earlier.

The following year will see adoption of a budget genuinely balanced on a cash basis.

Well before then, the City will have completed the installation, as required by State law, of a reformed accounting system in conformity with the standards of the State Comptroller and the Municipal Finance Officers Association.

Furthermore, the City will be functioning, as it is today, under a State-imposed ceiling on the amount of short-term debt it may have outstanding.

By the end of 1977-1978 it will have paid off approximately \$400 million of the money which has been raised by the Municipal Assistance Corporation this year to fund the accumulated deficits.

No one can say for certain, but given these conditions, and assuming that default will have been avoided, it is reasonable to expect that the City can begin on a small and gradual basis to issue long-term debt to fund its capital expenditures.

It is true that investors act on emotion as well as logic, and the fact of fiscal reform, when accomplished, combined with avoidance of default, may not promptly re-admit New York to the capital markets. But we know that the alterantive of default, if it occurs, will seal the markets to New York for an inevitably longer period, thus prolonging our dependency; will lose for us, probably forever, entire classes of investors who would never touch a debt instrument flawed by default; will further erode our economy as business firms flee the hazards and uncertainties of a bankrupt city with no hope for recovery; will probably trigger the default of New York State; and, beyond this, will have national and international consequences which none of us can clearly foresee.

As a second piece of information, I understand that the Committee wishes a report on the percentages of City spending in certain categories, exclusive of debt service. The City's budget for 1976-1977 will be expended approximately as follows:

Expenses:	<i>Percent of total</i>
Payroll—direct .....	39.5
Payroll, indirect—payments to independent agencies.....	3.5
Public assistance.....	12.1
Medicaid (including portion paid to Health and Hospitals Corp. <sup>1</sup> .....	14.1
Other welfare grants, charitable institutions.....	8.6
Pensions, social security fringes.....	12.2
Vendors contractors.....	10.0
Total .....	100.0
 Capital spending:	
Payroll .....	30
Vendors, contractors.....	70

<sup>1</sup> 4.6 percent paid to Health and Hospitals Corp.

A Mayoral Committee on default has drafted a contingency plan calling for an order of priority in seeking to maintain vital services in the event of default. As indicated earlier, even the total omission of debt service payments would require substantial cuts in other categories of expenditure, assuming that the New York State Constitution permitted such abrogation of obligations to holders of our notes and bonds.

Should it be established that the concepts of general obligation and full faith and credit do not mean what generations of investors have believed they mean, the consequences would be far-reaching for municipal borrowers and the nation's credit markets.

The CHAIRMAN. Thank you very much, Mr. Goldin.

Judge Rifkind, do you have any statement you would like to make?

Mr. RIFKIND. I would like to make a brief statement. If you would indicate to me how much time I have, I will confine myself to that.

The CHAIRMAN. Would you like to make a statement in 5 or 6 minutes? Is that all right? If you want to take longer, that is all right. Your views on this are extremely important to the committee.

Mr. RIFKIND. I would appreciate it, Mr. Chairman, if you would tell me when to stop; I am accustomed to it.

I am Simon H. Rifkind, a member of the firm of Paul, Weiss, Rifkind, Wharton & Garrison, lawyers in New York City and counsel for a State agency called the Municipal Assistance Corp. for the city of New York, otherwise called MAC by popular acclaim.

Mr. Chairman, you were kind enough to refer to the fact that I once served for this committee. Let me say that I served at that time under another great chairman of this committee, whose name was Robert F. Wagner.

I have been engaged in the practice of law since 1925, and you may wonder why at this late date I come here before you on two occasions, having been here last week also. The answer is a personal one.

It so happens that I passionately love the city of New York. I will try to speak dispassionately, but if a note of passion should emerge, it is because of the deep affection I have for the city where I have received my education, where my children live, where my grandchildren live, and where my parents are buried.

Now, Mr. Chairman, you referred to me as an expert in bankruptcy laws. It is true that for a period of time in my life, between 1932 and 1940, when there was no other game in town, except practicing bankruptcy, I made my living that way. But I like to identify myself as a trial lawyer, and that is my professional self-designation. It so happens I am currently the president-elect of the American College of Trial Lawyers.

Now, I have heard many people ask the question, why not bankruptcy for the city of New York; and I think that is the essential question you would like me to address myself to.

First, let me say that the very concept of bankruptcy is alien to an institution like the city of New York or to any great city, State, or nation.

The essential characteristic of the bankruptcy procedure is that the embarrassed debtor can say to his creditors, take my assets and let me go hence unburdened, I am out of business.

Neither the State nor the city nor this Nation can ever say to its creditors, take my assets, I am going to be liquidated, I am out of business.

Therefore, the essential key to the whole bankruptcy system is really not, strictly speaking, relevant to municipal affairs. It is true that we have sophisticated the bankruptcy idea. We now have the concept of reorganization in addition to liquidation, and there are elements in the reorganization procedure which could be appropriate to a city.

But at least let's realize we are not talking about bankruptcy in the old-fashioned sense. Now, I have some moral scruples about bankruptcy for a city like New York. It is a city which is larger in population than more than half of the nations now represented in the United Nations. But I will lay that aside and address myself strictly to some of the consequences of a default by the city of New York, and these will be, I think, stated in practical and not theological terms.

First, should the city default, there will be an increased cost for every public borrower around the country. You will observe that the mere threat of municipal default has created already such an increased burden on all of the municipal borrowers, State and city, around the country. And Comptroller Levitt on my right has had the direct ex-

perience of the effect of a possible city default upon the rates paid by the State of New York.

We are talking about amounts which will run into the billions and will be a burden upon the citizens and taxpayers of the United States.

This is not a local aspect ; there is a national aspect.

Let me cite some experiences from my personal professional exposure. New York City municipal securities have over the generations been very highly regarded as safe, prudent investments. There are many testators who funded their estates almost entirely in municipal paper. I have seen wills in which men of modest means set aside \$100,000 or \$200,000, invested it in New York City bonds, and turned them over to their executors with the instruction that, with this investment, you will have an income that is certain, that is trouble free, that is tax free, that needs no lawyers, no accountants, all you need to do is every 6 months present these coupons to the widow and she will have her living safeguarded.

Default will shatter the lives of elderly people around the country to an extent that we cannot know, but it must be enormous on the basis of such experience as I have had.

Let me tell you about another personal professional experience. A vendor came to me the other day, and he said to me, the city owes me \$23 million ; if there should be any question with respect to that asset upon my balance sheet, I am out of business because that is more than my total capital.

There are many banks in the city of New York, and around the country, according to what I have read, whose capital is to a substantial degree invested in New York City paper and in MAC paper. Let me tell you from my personal knowledge, what accountants have begun to do. Recently, an accounting firm preparing a public statement for a banking institution in this country noted the fact that such institution held a fairly substantial block of municipal paper and MAC paper. They footnoted such fact ; and the effect that footnoting has on an asset is : "Mr. Depositor, watch out."

Now, should this footnoting become universal practice, and should it appear that many banks have a substantial portion of their capital invested in these assets, and should there be a default ; I am not a banking man, I don't know, but I am sure it won't do those banks any good.

Any number of transactions, of all kinds and character that I have actually experienced in the course of a half century of law practice, are secured by a deposit of New York City bonds. They are treated better than a surety bond, better than a certificate of deposit. They are a safe security yielding tax-free income.

If the safety of those securities comes into question, any number of obligors, on all kinds of contracts, will suddenly be called upon to substitute a new security. The defaults will be enormous.

Next, we have the question of the future marketability of New York City paper in the public markets in the event that there is a default.

There you have twin problems. Some States have statutes which provide that any fiduciary may not invest in the securities of any obligor which has been in default within a certain period of years.

Among the States having such statutes that I know of, and I haven't gone through the 50 States, are Alabama, California, Florida, Illinois,

Massachusetts, New Jersey, and Pennsylvania. Some other States operate under the so-called prudent-man rule. Can you visualize the trustees that you have known; in your experience, are not all of them timid men when it comes to dealing with trust funds? Even my good friend on my right, the Comptroller, is very cautious when it comes to investing funds he holds in his possession as trustee. He might take a quite different attitude if he held them in his personal capacity.

Well, if a security is damned in six or seven States, do you think trustees are going to invest in those securities and be subjected to questions as to why they did so?

New York City is the headquarter city for an enormous number of American industries. A bankrupt city as the home for a corporate headquarters is an impossibility, I suggest to you, because there is fear that such a city will be subjected to higher taxes, that it will be a city down at the heel, that social services will be inadequate and that professionals will flee from the city because these very services will become substandard in the areas of schooling, hospitalization, and so forth.

Finally, New York City has a position as world financial capital. Being a world financial capital is a great national asset. It takes centuries to become a world capital of finance. It means an enormous flow of income to all of the people of the United States, and not necessarily just to the city of New York. It is not possible to have a world capital of finance in a city which is bankrupt and in which its bankruptcy reflects discredit upon the great banking institutions that are domiciled in that city. To dissipate such an asset is sinful, I suggest, because it is so difficult to recreate.

The CHAIRMAN. Judge, can you wind up in a minute or two?

Mr. RIFKIND. I will wind up with a reference to one metaphor I heard the other day, referred to by some public spokesman. He said the city of New York is looking at the stairway, and is waiting for a Federal elevator to come and take it to the fifth floor.

I would amend that and say the city is standing on a burning roof and there is a helicopter hovering above, lowering a 50-foot line, when it is 150 feet above the roof, and says to the poor fellow on the roof "jump and maybe I will rescue you."

The CHAIRMAN. The last witness on the panel is Mr. Kenneth Axelson. Mr. Axelson, do you have a statement you would like to make?

Mr. AXELSON. I have no statement, Senator.

The CHAIRMAN. Then we will begin the questioning of the panel.

Mr. Goldin, you say on page 11 that there is a mayoral committee that drafted a contingency plan calling for an order of priority in seeking to maintain vital services in the event of default.

Could you indicate to the committee what that will be in terms of vital services, how much of a reduction this would require, the degree of confidence which you and others may feel that this would be a practical procedure?

Mr. GOLDIN. Yes; I would be glad to, Mr. Chairman. I want to say at the outset that I personally have serious doubts as to whether under existing law the city would have the capacity, legally, to be able to vindicate its obligations to holders of bonds and notes, even if it were to wish to do so in the aftermath of a default.

The CHAIRMAN. You do have a 90-day period, however, there is no question about that; is that correct?

Mr. GOLDIN. The State statute, Mr. Chairman, provides for a 90-day moratorium on the filing of litigation. The issue as to whether that affects the underlying substantive commitment to pay debt services first is in doubt.

The CHAIRMAN. What does that mean?

Mr. GOLDIN. That means for 90 days nobody can sue. But that doesn't mean during the 90-day period I, as comptroller, may not have an absolute statutory obligation to take whatever is in the till and what may come into the till and pay it out to the holders of bonds and notes.

The CHAIRMAN. As I understand it on Friday when you were close to default there was some action taken, as I understand it, by a Supreme Court Justice providing that the priority, first priority would be city services and bond and note holders would not have their securities redeemed. Is that correct?

Mr. GOLDIN. That is correct, Mr. Chairman. On Friday morning I ordered an impounding of all checks to be issued from the city treasury. We didn't confront and would not have confronted, had we defaulted on Friday, the issue of who would have gotten paid first, because on Friday in the absence of the availability of credit, there was no money in the till to issue any check.

As a result, all checks were impounded. The city did secure an order, which was never served, which I understand that I was named as a respondent in, to establish an order of priority of payment for obligations or for expenditures that might mature in the aftermath of a default as money came in.

That statement was drafted, that list of priorities was drafted late Thursday night. It would have provided for payments first for life support services. Life support services defined as police, fire, sanitation, services necessary to maintain the adequacy of the city water supply, and to maintain basic public health.

The CHAIRMAN. Nothing for schools?

Mr. GOLDIN. No; that would have been rather far down on the list, Mr. Chairman.

The CHAIRMAN. The schools would have to be closed?

Mr. GOLDIN. They unquestionably would have had to have been closed because as I evaluated the cash flow on Friday, I discovered the following:

No. 1, no money in the till for us to make any payments whatever of any kind in the absence of credit on Friday.

No. 2, if the city were to have accumulated everything that came into its till over the course of the next week, having effected no payouts to vendors, no payouts for food and hospitals and prisons and schools, no payouts for people on public assistance, we would barely by 1 week after the Friday that was the critical day, would have accumulated enough if we paid out nothing else to cover that Friday's payroll.

The CHAIRMAN. You said nothing for hospitals?

Mr. GOLDIN. Nothing for hospitals, nothing for social service, nothing to pay vendors for the delivery of food, toiletries, essential supplies to the city facilities, nothing for any purpose whatever during the course of the ensuing week, after that famous Friday, could have been paid if we were to have tried to accumulate during the course of the

next ensuing week every nickle that came into the treasury to meet the general municipal payroll the following Friday.

The CHAIRMAN. Would it have been possible to maintain some degree of police and fire protection?

Mr. GOLDIN. Senator, it was reported during the course of the day on Friday, when the outcome of the credit was in doubt, that in connection with just one payroll that by reason of history we do effect every week as opposed to most payrolls which are effected biweekly—that having to do with the sanitation department—that when checks were stopped by me, as they were in the morning, not delivered or orders were issued to re-collect them at the distribution points, the radio reported that sanitation men walked off their trucks, left them in the middle of the streets, and refused to complete their day's work.

I don't think there can be any doubt that in light of the substantial uncertainty in succeeding days, had we defaulted, and the very real doubt as to whether we would have been able to have accumulated enough cash to effect payments of the payroll the following Friday, that there could have been massive disruption of essential critical services, police, fire, sanitation, not to speak, Mr. Chairman, of what the consequences might have been if the city—as we would have had to, to meet that payroll the next Friday—cut off every other payment in any category whatever, including as I said payments to the recipients of social service, welfare, payments to hospitals for advances, payments to vendors for essential food and other staples, everybody would have to have been cut off.

The CHAIRMAN. That was a sudden, unexpected action which precipitated you toward default.

Now with the anticipation that sometime shortly after December 1, if there is no Federal assistance, the city would go into default, under those circumstances you have time to make plans and so forth, what will happen?

Mr. GOLDIN. The Board of Estimate has been in session discussing that issue and trying to formulate plans. I think maybe it would be helpful if I gave you this information. I pointed out to you we would have a cash operating shortfall in the absence of the payment of debt service in December alone of some \$387 million.

I would like to read to you the categories of payments—there are only seven—that would be effected in the ordinary course in December, and tell you the amounts that relate to each and you will see the problem that confronts the managers of our city.

The first is payroll in all categories, during the month—\$357.5 million. We have no debt service payments in the month of December.

I am sorry; Mr. Clifford reminds me that I am reading you a cash flow that assumes no debt service payments. So under this schedule we would forgo our debt service payments in December.

Assuming therefore we forewent all of the debt service payments in December: payroll, \$357 million, welfare, medicaid, and related essential social service expenditures, \$262.4 million during the month.

Transit authority, health and hospitals, independent organizations of that kind, \$38.8 million.

Pensions, insurance, social security, fringes of various kinds, \$84.8 million.

Payments to vendors to the city, \$199 million.

And capital payments in all categories, including, as I pointed out, a large portion of our capital budget, that although we are beginning to phase out expense budget items from it, there remains yet committed to expense type items, \$125 million.

The CHAIRMAN. What I am trying to get is a picture of what happens in the event you go into default—with respect to your essential services.

I think my time is about up. I would like to get the advice of Mr. Levitt on what he and you, Mr. Goldin, could do to use the funds that are available to the State to some limited extent, perhaps, in one way or another, such as the retirement funds to which you referred?

I am told by some that the State of New York has something like \$20 billion in pension funds. That may be an exaggeration. At any rate, it would seem we should have a very clear understanding of the capacity of the State and city to meet these tremendously urgent needs from its own resources.

Mr. LEVITT. The State of New York has a New York State Common Retirement Fund. It is named that because it embraces the employees of the State as well as the police and firemen of the State outside of the city of New York.

I am the sole trustee of that fund, \$7.2 billion. I believe I am the only one in that position in the United States; all of the other pension funds have multiple trustees.

I have been the sole trustee since 1955. The Legislature in the State of New York, which has been predominantly Republican, and I am a Democrat, during all of the years of my incumbency, has seen fit to allow me to remain in that unique position.

This has to be because they have faith in my personal integrity and in my capacity to fulfill the responsibilities of a trustee.

I intend to keep that faith. The problem that confronts me is the restrictions that rest upon a trustee or fiduciary. I am a fiduciary of this fund which I do not regard as a public fund in any sense at all. A good part of this money is money contributed by the members of the system toward their annuity accounts. The rest of it was contributed by the State government, in this case, in this year, \$400 million, and \$400 million by the localities who are members of our system.

The pensioners, the members of the system, regard this money as their own, not as public funds. They contend, rightly I think, that they have earned it, and that these pension benefits furnished by the State and localities are, in a real sense, a substitute for increases in salary.

In any case, I am governed by the statutes of the State of New York that direct investments. And as I see it—have seen it for the past 21 years—there are two criteria that should govern my investments, safety of principal and yield. And those are the criteria I intend to adhere to.

From time to time in the course of my incumbency, I have been urged by different groups to depart from those criteria and to modify them, to serve some social purpose or other. I have resisted that, and I think I was right, and I intend to continue to resist it.

[It was requested that the following appear in the record at this point:]

CONSEQUENCES OF NEW YORK CITY DEFAULT UNDER STATE LEGAL INVESTMENT LAWS

SUBMITTED BY THE GOVERNOR'S OFFICE, NEW YORK STATE

This memorandum sets forth in tabular form those categories of individuals and institutions which might be precluded, under the legal investment laws of the various states, from purchasing securities issued by a municipality that has previously defaulted on its indebtedness. The following should be noted in reviewing this memorandum:

1. The legal investment laws relate to permissible investments by such persons and institutions as trustees, executors, administrators, guardians, banks and insurance companies. The information set forth in this memorandum with respect to the state legal investment laws governing trustees, executors, administrators, guardians, trust companies and savings banks has generally been obtained from Volume 4 of the Prentice-Hall Estate Planning Reporter. The P-H Reporter does not cover investments by insurance companies or, with the limited exceptions noted in the table below, investments by banks other than savings banks and trust companies. Further research is presently being conducted into the restrictions governing investments by such institutions. However, preliminary examination of the insurance laws of several major jurisdictions, as set forth in the CCH Blue Sky Law Reporter, indicates that similar investment restrictions may be applicable to insurance companies in certain states. (See table below.)

2. Some states do not allow purchase of bonds issued by out-of-state cities under any circumstances (e.g., Utah). Hence, default has no impact.

3. Some states permit certain of the categories of fiduciaries to purchase securities which are eligible for purchase by certain entities organized under federal law. For example, Texas allows trust companies to purchase any investment which a national bank could purchase. The regulations of the Comptroller of the Currency permit unlimited investments by national banks in municipal securities, subject only to the Prudent Man Rule described in note 5 below.

4. Those states in which default on a city bond has some impact are listed below. These default restrictions generally do not apply to all categories of persons covered by the legal investment laws of the relevant state (e.g., savings banks but not trustees might be precluded from purchasing bonds from a city which has previously defaulted). The affected category or categories are noted in the table. This memorandum has not attempted to include the highly specific default provisions of certain states which are applicable only to certain agencies or instrumentalities of a city (e.g., highway authority bonds).

5. In certain states not included in the table because there is no explicit provision limiting investment in the event of a default, there may be other legal investment provisions which indirectly have the effect of eliminating securities of an issuer which has defaulted from the fiduciary, bank and insurance company investment markets. For example, certain states have credit rating and/or net worth requirements applicable to municipal securities. In addition, the Prudent Man Rule which is applied in many states may preclude investment in municipal securities that are deemed to be unduly risky. A common version of the Prudent Man Rule requires a fiduciary to "exercise the judgment and care under the circumstances then prevailing, which men of ordinary prudence, discretion and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income therefrom as well as the probable safety of their capital."

<i>State and affected category</i>	<i>Restriction</i>
Arizona: Insurance companies....	Investment precluded if security is then in default in any respect; investment precluded if there has been default on any other security within 5 years prior to investment.
Arkansas: Guardians (ward).....	Investment precluded in an issue of securities which has been in default for period exceeding 120 days in 5 years preceding investment.

<i>State and affected category</i>	<i>Restriction</i>
Arkansas: Insurance companies---	Investment precluded if security is then in default in any respect; investment precluded if default in principal or interest on obligations to be purchased within 5 years prior to investment; or if issued less than 5 years prior to investment, no default on principal or interest on any issuer obligations within 5 years prior to investment.
California:	
Commercial banks and savings banks (for their own account).	Investment precluded in bonds or other evidences of indebtedness if default on any part of principal or interest on any debt for a period of more than 90 days in 10 years prior to investment.
Insurance companies-----	Investment precluded if security is then in default as to principal or interest; or if obligor has defaulted on any part of principal or interest on any legally authorized obligation issued by it for more than 90 days within 2 years prior to investment.
Colorado: Guardians of minors and incompetent beneficiaries of VA benefits.	Investment in bonds or other securities permitted if issuer not in default with respect to principal of any of its general obligation indebtedness at any time within preceding 10 years.
District of Columbia: Trustees, executors and administrators.	Investment in bonds obligations precluded if default in the payment of any part of principal or interest on any of lawful obligations for more than 120 consecutive days at any time within 20 years preceding the investment.
Florida:	
Guardians holding funds received from VA.	Investment precluded if default on any part of interest on bonded indebtedness for more than 90 days within 15 years prior to investment.
Bank or trust company-----	Bonds and securities invested in must be current as to all payments of principal and interest.
Insurance company-----	Investment precluded if security is then in default in any respect.
Georgia: Banks-----	No restrictions in Prentice-Hall but the Department of Banking and Finance is authorized by statute to promulgate regulations.
Hawaii: Trust companies and savings banks.	Bond investment precluded if any default in payment of principal or interest of any general obligation within 5 years preceding investment.
Idaho:	
Corporation doing trust business.	OK if bonds are acceptable by U.S. Government as security for deposits of postal savings bonds.
Savings banks-----	Investment precluded if default in interest on legal funded debt in 3 years preceding the investment.
Illinois:	
Guardians -----	Investment precluded if default in a payment of principal or interest on bonded indebtedness during 5 years prior to investment.
Insurance company-----	Investment precluded if municipality is then in default on payment of principal or interest on any of its direct, general obligations.

<i>State and affected category</i>	<i>Restriction</i>
Iowa : Savings banks-----	Bond investment precluded if such bond or security shall have been in default as to principal or interest for 5 years preceding investment. (Superintendent has further power to define permissible investment characteristics of bonds).
Kansas : Savings banks-----	No bank permitted to invest in excess of 15-percent capital and surplus in bonds if any bond, security or evidence of indebtedness has been in default of payment of principal or interest within 10 years prior to investment.
Massachusetts: Savings banks----	Bond investment precluded if default in payment of any part of principal or interest on bonds, notes or other interest bearing obligations for a period of 120 days within 10 years preceding investment.
Michigan : Insurance companies---	Investment precluded if failure to pay principal or interest of debt for a period of more than 6 months within 3 preceding years; investment in bonds or other evidences of indebtedness permitted if by statutory or other legal requirements, such obligations are payable, as to both principal and interest, from adequate special revenues pledged or otherwise appropriated by law required to be provided for the purpose of such payment.
Missouri: Banks and trust companies.	Banks and trust companies in cities with population of 100,000 or over precluded from purchasing bonds in excess of 15 percent of capital and surplus accounts if any default in payment of principal or interest on general obligation bonds or other evidences of debt for period of more than 120 days in 10 years preceding investment.
Nebraska :	
Trust companies-----	Unclear whether there is authorization to purchase New York City bonds; if there is, precluded from purchasing bonds the interest on which has been in default for a period of 2 years preceding purchase date.
Insurance companies-----	Investment precluded if municipality has defaulted in payment of any principal or interest on its bonds, securities or other evidences of indebtedness within a period of 2 years preceding investment; except that investment permitted in a refunding issue of any such bonds where security for the indebtedness refunded has been increased or the principal or interest rate reduced or maturities extended, if there has been no default in principal or interest of the refunding bonds.
New Jersey :	
Fiduciaries -----	Investment precluded if default in payment of any principal or interest on any stocks, bonds, interest bearing notes or obligations within 120 days preceding investment.
Savings banks-----	Cannot invest in bonds of New Jersey or non-New Jersey city if such city has defaulted for more than 60 days during last 10 years prior to investment in payment of principal or interest on any debt.

<i>State and affected category</i>	<i>Restriction</i>
New York :	
Savings banks-----	For non-New York State cities, investment in is precluded if a default for more than 120 days in the 25 years prior to investment. Does not cover New York State cities.
Banks (other than savings banks) and trust companies.	Investment precluded if securities to be acquired are in default as to principal or interest at the time of acquisition.
Insurance companies-----	Reserve investment precluded if securities to be acquired are in default as to principal or interest at time of acquisition.
Ohio :	
Fiduciaries -----	Investment in non-Ohio city bonds subject to Prudent Man Rule. For Ohio city would be a precluded investment if city had defaulted for more than 120 days in last 10 years. Under the Prudent Man Rule, default by non-Ohio city may bar further investment in securities of that municipality.
Savings banks-----	Investment precluded if city has defaulted for more than 90 days in last 10 years.
Insurance companies (life)---	Investment precluded if securities acquired are in default as to principal or interest at time of acquisition.
Insurance companies other than life.	Investment precluded if municipality had defaulted in payment of principal for a period of more than 1 year, or payment of interest for more than 120 days on any of its securities, within 10 years preceding the investment.
Oregon : Guardians-----	Without court order, cannot invest in bond of Oregon city which has defaulted within last 5 years for any period. Seems : Non-Oregon city bonds are never a permitted investment.
Pennsylvania : Fiduciaries (guardians, committees, trustees and other fiduciaries subject to jurisdiction of court of common pleas, not including personal representatives.	Investment precluded if municipality is not current in payment of any part of principal or interest owed by it on any part of funded indebtedness on date of investment.
Tennessee : Trustees, guardians and fiduciaries.	Cannot invest in any municipal bonds if defaulted for more than 30 days in last 25 years on principal or interest of any debt.
Vermont : Banks-----	Can invest in bonds of cities outside of Vermont if issuer not in default at the time of investment.
Virginia : Executor, administrator, trustee or other fiduciaries.	Investment precluded if security to be acquired is in default or has been in default for more than 90 days ; investment precluded if city has been in default on principal or interest of any security issued by it for more than 90 days in the last 20 years.
Washington : Insurance companies--	Investment precluded if security to be acquired is then in default in any respect at time of acquisition.
West Virginia : Trustees, executors, administrators, guardians.	1. State bonds are impermissible if any default in last 10 years.
Trust companies-----	2. City bonds are always impermissible.
	1. Usually a limitation placed on investments in any security ; but
	2. No limitation on city bonds if city has not defaulted in last 10 years.
Wyoming : Guardians-----	Cannot invest in city bonds if defaulted for more than 30 days in last 10 years.

The CHAIRMAN. The problem is we are told repeatedly, over and over, if the Federal Government will provide the guarantee, there won't be any real risk; the Federal Government will not lose money, they will make money. This may not be the case. We are told this with complete sincerity, I am sure. That is why we as Federal officials feel that the State of New York, if they have confidence that this system when put into effect is going to work. The budget is going to be balanced, as you and Mr. Goldin so carefully and ably spelled out. Why can't you then make a very substantial investment, such to provide for a great deal of the essential services, perhaps all of them.

Mr. LEVITT. Mr. Chairman, wouldn't you consider an investment of \$275 million a substantial investment?

The CHAIRMAN. I would. But you said you had \$71½ billion.

Mr. LEVITT. That is right.

The CHAIRMAN. Would it be unwise or not prudent in your judgment to invest \$1 billion or \$1½ billion of that in the event that you have the authority and some of the earning power of the State of New York to enforce its will, as they have indicated they will, and move the city toward this balanced budget we are assured will develop by 1977-78?

Mr. LEVITT. That was my conclusion, Mr. Chairman, when I was urged from all quarters to make a further commitment in the so-called MAC bonds beyond the commitment already made. It was my conclusion that it would violate the prudent-man rule if I were to do that. In any case, it was contrary to my own best judgment as to the scope of investment I should make as a prudent investor.

The CHAIRMAN. In other words, what you are telling us is that you would feel bound by the laws of the State, by your own judgment, by the obligation that you have to the persons whose funds are entrusted to you, not to invest additional funds in the event that the city goes into default. Is that correct?

Mr. LEVITT. I would be bound by the rule of prudence and by the concept I described before, that requires me to consider safety of principal and yield, and also by the principle of maintaining a balanced portfolio.

So to all of these things, I have the advice of a statutory committee, an investment advisory committee of nine people, and I have followed their advice in coming to the conclusion I express here.

The CHAIRMAN. My time is up.

Mr. RIFKIND. I just want to add a footnote to what Mr. Levitt said. The legislature, contemplating this very problem which the chairman averted to, did pass legislation directing the comptroller to make a specified investment in MAC bonds out of the pension fund. That legislation was challenged by the employees whose funds were affected. Our highest court declared that that provision of the statute was unconstitutional and threw it out.

The CHAIRMAN. Senator Brooke.

Senator BROOKE. Mr. Goldin, you, like many of the New York officials and representatives of New York banks, have indicated the great concern that if New York defaults, the bond market will be adversely affected and other States and other cities, as well, will suffer.

Now, last Wednesday I put in the Record the fact that the State of Pennsylvania had offered a \$500 million note sale, and according

to the Wall Street Journal, Pennsylvania's notes attracted such heavy demand they were quickly marked up in price, to reduce their yield to 4.9 percent from the original 5 percent.

The same day, excellent quality also was represented by Georgia's \$48 million of new bonds. The Washington Post has reported that the State of Maryland and Fairfax County sold more than \$95 million worth of bonds on the 22d of October, at interest rates substantially below those they had paid in recent years, indicating that New York City's financial crisis has not had adverse effect or impact on all municipal bonds. And the head of Morgan Guaranty Trust Co.'s municipal bond department said: "The problems of State and local governments have been thoroughly discounted by the market. Those jurisdictions that still look good will not be penalized simply because other municipalities are in default."

Do you have any comment about these facts? As I understand it, you and others have been basing your statements on primarily speculation, that the bond market might be adversely affected. But these are facts: Pennsylvania, Georgia, and now Maryland. What is your view?

Mr. GOLDIN. Senator, you are correct, in the aftermath of a default, the possible consequences I would agree are conjectural. But I would like to offer this: New York probably provides in its constitution and local finance laws assurances for investors that are as ironclad, as secure, as any provided anywhere in the United States. In the aftermath of a default, there is no question that, especially in the context of the chairman's comment about the pressures to deliver essential services, and even as you will note I remarked if we paid no debt service, we would have to slash critical life support services. In the aftermath of that kind of development, litigation, testing the meaning of those protections and guarantees which surely result.

I don't know, Senator, what a court would say about the meaning, historically understood, of full faith and credit, which underlies the security of municipal finance, which provides for the relatively lower interest cost that is paid by issuing jurisdictions and taxpayers, as against other forms of obligations. I don't know what courts would say about the historic basis for the confidence in the purchasing of municipal obligations, tax-exempt obligations everywhere in the United States.

So, while it may or may not be true that during a period of confusion and uncertainty, which has been prolonged, certain superior credits have not experienced, because perhaps of the size of their issues or other matters, their inherent credit worthiness, the problems anywhere near what we have.

In the aftermath of the litigation that would raise and settle these issues I would be very fearful about the effect of that one issue alone, on public finance in America.

Senator BROOKE. You admit this is conjectural. I agree that you will have problems in New York City, but it is not going to necessarily create problems for cities around the country as well, merely because New York cannot live up to its bond obligations.

Mr. GOLDIN. Senator, you are clearly correct, that no body can establish definitely what the consequences of default are. But I would suggest to you that the reasonable possibilities are so mind-boggling, that whatever the quantity of the risk may be of any one or more of them

occurring, it is a risk that it is hard for me to imagine that this country would want to take.

You are correct, nobody can say certainly that the effect of the possible violation of the historic understanding of full faith and credit would adversely affect other jurisdictions. It might very well. Nobody can state with certainty, Senator, that in the aftermath of a possible New York City default there might be general liquidity problems or at least that there might not be some adverse impact on interest rates with consequent inflationary impact on State and local governments, higher costs of borrowing, higher tax rates, and possible reductions in service. Nobody can say for certain, Senator, and I certainly wouldn't purport to know what the effect might be on the money market, the potential erosion of discretionary or hot money. I wouldn't want to take the risk of the possible consequences on the position of the American dollar abroad.

I have concentrated, because it is my area of greatest concern, on the effect to New York City alone and I tried to speak to that in direct and factual terms.

But in the context of your question, it seems to me, the potential consequences of a default, which nobody can establish with certainty, are of sufficient magnitude so that any reasonable risk of their occurring is dangerous to the country.

Senator BROOKE. You raised that question in your statement though.

Mr. GOLDIN. I did.

Mr. LEVITT. Mr. Chairman, May I speak to Senator Brooke's point?

The CHAIRMAN. It is up to Senator Brooke.

Senator BROOKE. Yes.

Mr. LEVITT. Senator Brooke, I watched with great interest the sales recently made. These are friends of mine that engaged in the sales and I called to congratulate them upon it. I suggest to you, sir, that they were made in view, and the successful achievements you referred to, is based in large part on the expectation on the part of the investment community throughout the nation that the Federal Government will, indeed, come to the aid of New York City. And that New York City will not default. I suggest, too, in the event New York City does default, in the event of such an unhappy occurrence, those who are concerned with the selling of municipal obligations throughout the Nation will find a greatly changed market. People will say, "How can we conceivably invest our money in a municipal obligation if the great city of New York went into default?"

Senator BROOKE. Are you suggesting, Mr. Levitt, that these States and cities were successful because investors believed that the Federal Government was going to guarantee New York's bonds, and that if these States and cities got into trouble, the Federal Government would be prepared to guarantee bonds for them as well?

Mr. LEVITT. No, I don't think they had that in mind at all. They certainly wouldn't think that of a triple "A" obligation like Maryland's. But for a while, Senator Brooke, there was a disinclination on the part of anyone to invest in any kind of a municipal obligation. Even the school districts in the State of New York, which have security, which makes them second only in terms of security to obligations of the Federal Government itself, even they were unable to get reasonable interest rates.

But that period of apprehension is being dissipated, it has passed with the passage of time. There is a lot of money in the country awaiting investment, and here confronted by the offerings of a really modest amount of triple "A" obligations they came in and bought it—

Senator BROOKE. All conditioned upon the Federal guarantee of New York City bonds?

Mr. LEVITT. No, I think they were put into a feeling of security. The apprehensions they entertained up to now had been dissipated to some extent.

Senator BROOKE. But these investors are sophisticated. They must know there is at least a chance that the Federal Government is not going to guarantee New York City bonds.

Mr. LEVITT. I was surprised by the extent to which these sophisticated investors react to purely emotional considerations.

Senator BROOKE. Those investors must know more than we know in the Congress if they have already written up the guarantee for New York City bonds, and based upon that they have gone out and guaranteed \$95 million for Fairfax County and—

Mr. LEVITT. I am afraid I didn't make the point clear. I am not suggesting they depend upon the guarantee of the New York City obligations. What I am suggesting is that the period of despair, the period of grave apprehension, the period of almost panic that obtained when this New York City situation first came upon us has become eased by these hearings, by the expressions of important Members of Congress. And that hence, people feel freer to invest in municipal obligations.

Senator BROOKE. I suggest to you most respectfully, sir, that the grave apprehension still remains, and that these investors are just too sophisticated to believe that they can base their decisions about the purchase of bonds on the statements of a few Members of the U.S. Congress. I just can't believe that. But we want to move on if we can. At least Mr. Goldin put it in the realm of conjecture. I think you put it beyond that by your statement, Mr. Levitt, that you really believe if we don't guarantee New York bonds, well, it will have a disastrous effect on the bond market.

Mr. LEVITT. Yes, I do, indeed.

Senator BROOKE. Now, Mr. Goldin, option one being considered by the committee sets a limit of \$6 billion on the amount of New York obligations that the Federal Government can guarantee, this in addition to \$1 billion in privately financed, nonguaranteed obligations will provide up to \$7 billion in credit for the city.

Is the figure of \$7 billion adequate, and, if so, on what is this estimate based?

Mr. GOLDIN. Yes, Senator, that figure will be adequate and will most assuredly enable us to meet our credit requirements, both over the immediate, intermediate, and the longer term.

The CHAIRMAN. Even though as you recall Mayor Beame said \$9 billion, and Governor Carey said \$5 billion, and I think you said now we have to have \$7 billion.

As I understand it, this is because New York will have a need for some \$2 billion of interyear borrowing.

Where and how will New York borrow this \$2 billion?

Mr. GOLDIN. Perhaps I can undertake to try and clarify some of what appears to be conflicting numbers. To a degree, Mr. Chairman, members of the committee, the competing numbers derive, depending on what kind of a statement of figures is being worked with, whether it is a budgetary statement, a cash flow statement, a debt statement, and so forth. And so I would urge the committee to recognize that it is the document and the method of presentation of figures that can create awkwardness in the presentation of the numbers. The numbers of the committee may have, and I hope you do—if not, I would like to see that you get it for your convenience—a budgetary statement of the financial plan adopted just a few days ago by the emergency financial control board chaired by the Governor. It indicates definitive numbers. It provides that for the balance of this year total revenues of the city will be just under \$8.4 billion.

On the other hand, because it is a budgetary statement, and does not acknowledge the complexities of the interrelationship of revenues and expenditures, it includes as a revenue item in the general fund payments for so-called MAC take-out, the service of obligations of the Municipal Assistance Corp., revenues which heretofore would have been revenues of the city, but which will not longer flow directly to the city and will be flowing out first when collected by the State to meet obligations on MAC.

Second, that statement that was prepared and has been submitted indicates the total expenses of the city, excluding debt-related items, will be \$7,387 million, and that, therefore, the debt service component is \$1,669 million.

Some have asserted that it would appear, therefore, based on the debt service figure, that if New York City were not to pay debt service, that we would have adequate cash between now and the end of the year in which to meet our other essential obligations.

I dealt with that at length in my statement.

Let me recapitulate. That \$1,669 million item for debt service excluding the roll-over of existing obligations comprehends a \$380 million, \$390 million payment this year to service MAC obligations. Even if the city were to renounce its debt service in the aftermath of a possible default, there would be no way we could avoid the payment of that item, because those revenues, as I indicated a moment ago, in suggesting that revenues would be reduced, are also not available to us and as a result we would have an adverse cash picture for the balance of this fiscal year.

The fact of the matter is, Senator, that the definitive numbers are as follows: We have between December and the end of the year, a financing requirement of some \$3,900 million. We will end the year with an end-of-year debt position of some \$4,200 million. We will, in the next fiscal year, be rolling that over and financing additional requirements.

I want to point out to you, if I may, Senator, and members of the committee, that the summary financial statement from which I read does not include essential expenditures by the city that have historically been financed under our capital budget.

Because of past fiscal practices, many of our capital expenditures are really essential expense items, salaries and essential services.

When you add to the roll-over from the end of this fiscal year, the essential financing requirements in the next fiscal year, we would have total financing requirements in 1976-77 of some \$5.8 billion.

Now I understand from consultations with the staff and consultations that I have had and my staffs have had with theirs, that plans can be formulated and we have tried to contribute to that and develop models, showing that as a result of modest increases in the city's real estate tax, not exceeding and perhaps even undermeeting the rate of inflation, we would be able thereafter to start reducing our debt position, to start funding debt, to start paying off accumulated deficits, it would not require to go above the figure you cite.

Senator BROOKE. Mr. Chairman, my time is up. I yield.

The CHAIRMAN. Before I call on Senator McIntyre, I would call to the attention of the witnesses the fact that we do have other witnesses following, four other witnesses. We have a number of members present who are very anxious to question them. I do hope the witnesses will make their responses as consistent as they can.

Senator McINTYRE. I will see if I can make the questions short.

Mr. LEVITT, what will happen to New York State if New York City defaults? Will the State default, too?

Mr. LEVITT. That is a question that gives me the great anguish to even address or contemplate.

Senator McINTYRE. What is your opinion?

Mr. LEVITT. We have a huge borrowing program in the State of New York. Much of it is for the benefit of the city of New York, but a great deal for the State itself. I had to borrow, in November, \$250 million. In December, another \$250 million. In the spring of this year, I shall have to make my usual tax anticipation borrowings of the banks, amounting to \$3.85 billion.

In other words, what is in prospect for the State government itself is borrowings in the total of \$4.75 billion. And, furthermore, if the State runs a deficit as is anticipated in some quarters, the amount of that deficit I shall have to borrow for and add to the overall borrowings.

At the present moment, as recently as 3 weeks ago, I was not able to borrow any amount for the State from the New York City banks. So if the city defaults, I would have grave apprehensions about the financial future of the State.

Senator McINTYRE. You think it would probably default, too?

Mr. LEVITT. Well, I think that would be a great likelihood; yes.

Senator McINTYRE. Now, is the program for assistance, option one we are discussing—you are aware of the plan we are proposing, aren't you?

Mr. LEVITT. I haven't seen the measure.

Senator McINTYRE. It has been drafted to avert default. Do you think it is adequate to insure the necessary accountability on the part of the State and the city, while assuring its own reentry and that of its agencies into the capital market?

Mr. LEVITT. I can't speak for the agencies, but I think a demonstration of support would enable the State government itself to borrow.

Senator McINTYRE. What about other cities in the State if New York City defaults?

Mr. LEVITT. The other cities are having difficulty right now. I am bombarded almost daily by requests for help from cities throughout the State, from special districts, school districts, and the like, and I have been able to respond to a very limited extent. But if there should be a default on the city of New York, that bodes ill for every city in the State and I suggest for cities throughout the Nation as well.

Senator McINTYRE. What assurances, Mr. Goldin—and I think you have answered this question—what assurances, if any, do we have that the current program to restore financial discipline to the city of New York will succeed in our long-range objective of restoring confidence in New York City obligations?

Mr. GOLDIN. Jail terms for the officials of the city or State who violate them.

Senator McINTYRE. You are the only elected official on the panel?

Mr. GOLDIN. No, sir; the comptroller of the State is also elected.

Senator McINTYRE. Excuse me.

What is all this about rent control and your revenue base being diminished. The Wall Street Journal makes a big deal, that the rent control situation in New York City is deplorable. Should we make a condition that you remove rent control?

Mr. GOLDIN. I think that would be a mistake, Senator. I think the interest of this committee, the Congress, and the Federal Government should be, number one, to extend reasonable, quantifiable assistance over a definable period to help New York City get back on its feet.

Second, to be presented with projections that satisfy the committee and satisfy the Congress, that based on careful and prudent calculations, there is a real light at the end of the tunnel. I think we can satisfy that.

Number three: Assurances that are substantial in law, including instrumentalities which exist, that the city has got to obey the requirements of the new day, including honest accounting and budgeting, disclosure, oversight, review, and a balanced budget by fiscal 1977-78.

The details of the agony we are going to have to experience in the city as to how we cut back, we have already started that, but I tell you it has not yet begun, ought to be a matter left to the local determination of the people of the city and State of New York.

Senator McINTYRE. As I understand it, in answering the question, you said you couldn't speak for the State agencies?

Mr. LEVITT. The State agencies, Senator, do not fund themselves with full faith and credit obligations. They utilize the so-called moral commitments.

Senator McINTYRE. I thought I saw somewhere, an article in the Wall Street Journal, that one of your housing authorities in the State was in trouble.

Mr. LEVITT. That is the Housing Finance Agency. And that is a truly viable agency.

Senator McINTYRE. They are having difficulty?

Mr. LEVITT. They have revenues they can point to and count on to support their borrowings and they can't borrow.

Senator McINTYRE. You mean they can't borrow at a rate of interest they are willing to accept?

Mr. LEVITT. They can't borrow at any rate.

Senator McINTYRE. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Packwood.

Senator PACKWOOD. Mr. Levitt, if you are saying those who underwrite bonds in this country are going on the assumption that Congress is going to guarantee New York bonds, why can't the Housing Authority sell the bonds?

Mr. LEVITT. I am not saying that. Perhaps I haven't made myself sufficiently clear.

I am saying that the general feeling abroad is that some kind of aid will be extended to the city of New York. People have said in New York State, for example, the State will never let the city default. Now they no longer say that, but they do say the Federal Government will never let the city default, they can't let the city default, in view of the awful consequences. I think this feeling pervades the Nation. And while people go out and buy the bonds of Maryland, in reliance upon the full faith and credit of the State of Maryland, they are not really relying on any expectation that the Federal Government will ultimately guarantee those obligations. They feel better; they feel more secure in going into the municipal market at all because of the general feeling that the Federal Government will look to the restoration in State and local governments of fiscal sanity and will support it in an emergency such as confronts New York.

Senator PACKWOOD. I went to the law school in New York, NYU, and I can assure you that the feeling that you just described does not pervade this country, and there are not millions of people running around saying, "Save New York." If anything, the contrary exists in this country, or at least outside of the confines of Albany and New York City. I look at the bond issues Senator Brooke referred to, I have the same article. Maryland had \$3 billion, Fairfax County had \$6 billion, the two winners were Morgan Guaranty on Maryland and First National City on Fairfax County and both of their chief officers were here testifying a short time ago, pleading with us for a guarantee, or some bailout.

Are they operating under the assumption that they are going to get it, and I don't think they are—

Mr. LEVITT. I don't believe they are.

Senator PACKWOOD. Yet they are willing to go ahead and make these underwriting bids. These are not children in a municipal toyland. These are adults who understand the market.

Mr. LEVITT. All I am suggesting is that the climate is quite different now in the municipal market than it was several weeks ago.

Senator PACKWOOD. That is because everybody, I think, is assuming New York is going to default.

Mr. LEVITT. I don't agree with that at all.

Senator BIDEN. Will the Senator yield on one point to read a paragraph in the article?

Senator PACKWOOD. Yes.

Senator BIDEN. It says, "William S. James, Maryland State Treasurer, said contrary to his original fears, New York problems appear to have actually helped his State rather than hurt it. 'This is because New York City difficulties make us look better,' " I think that corroborates what the Senator is saying.

Senator PACKWOOD. I want to go back to the investment of the \$7.5 billion you have control of. What happened in the legislature? You didn't want to invest in New York City bonds?

Mr. LEVITT. The legislature passed a bill that mandated that specific investment.

Senator PACKWOOD. It went to court; it was all of the beneficiaries?

Mr. LEVITT. Some of the beneficiaries.

Senator PACKWOOD. Enough of them to have a standing in court, who said "Wait a minute, we don't think this is a prudent investment, and we will sue to stop it."

Mr. LEVITT. They said more than that. They said the comptroller doesn't think it is a prudent investment.

Senator PACKWOOD. And you didn't?

Mr. LEVITT. Well, I would have made it if I thought so.

Senator PACKWOOD. You wouldn't make it; the legislature ordered you to make it; the court of appeals said you can't be ordered to make it. Did you make it then or not?

Mr. LEVITT. No, I had made a \$25 million investment in the MAC bonds, and I considered that sufficient in light of overall judgment considerations.

Senator PACKWOOD. As of today, anything beyond that, I believe, for you would be an imprudent investment?

Mr. LEVITT. That was my conclusion.

Senator PACKWOOD. And that is your present conclusion?

Mr. LEVITT. That is my present conclusion.

Senator PACKWOOD. I have no other questions.

The CHAIRMAN. Senator Cranston?

Senator CRANSTON. I have no questions, but I do want to welcome Arthur Levitt, with whom I became very well acquainted in the past, when I was State controller of California.

I do have one short question. One can find all sorts of things in the Wall Street Journal, and today, in some substantiation of concerns that have been raised about the consequences, ripple effect, and so forth of New York's problems, one point that has been made is concern about the value of the dollar. The Wall Street Journal today reports: "Hounded by declining American interest rates and the New York City financial plight, the dollar skidded in France further to a three-month low."

So there are things happening in the direction people have been expressing concerns about.

Because I know we are all eager to hear Adlai Stevenson, I will withhold further questions.

The CHAIRMAN. Senator Helms?

Senator HELMS. Mr. Goldin, I believe your job is elective; is that correct?

Mr. GOLDIN. Yes, sir.

Senator HELMS. In your campaign for office, did you call to the attention of the people of New York what must have been an obvious situation of distress at that time?

Mr. GOLDIN. To the extent that I knew it. Senator, I did.

Senator HELMS. Well, to what extent did you know it?

Mr. GOLDIN. Not to anywhere near the extent that obtained.

Senator HELMS. In other words, it was a deep dark secret that the city was going broke even at that time?

Mr. GOLDIN. I would say to you for a variety of reasons, including the ways in which the city's accounts and records were maintained, the accounting systems that were used by the city, other factors, the extent of the difficulty was not known.

Senator HELMS. Do you have an opinion when most of the damage was done, in terms of a period of years?

Mr. GOLDIN. I think, Senator, it was cumulative over quite a number of years. There was a time, many years ago, when the practices that ultimately led to the financing mechanisms that got the city into trouble were developed, one after another, usually to a very small extent. They were legal, they were within the law and very rapidly during the period of the mid-late sixties, even seventies, they were escalated and got out of hand.

Senator HELMS. Well, do you have an opinion as to whether it was deliberately covered up or not?

Mr. GOLDIN. When I became comptroller, Senator, I commissioned three independent public accounting firms to undertake independent verifications of assets, accounts, bookkeeping methods, and various other matters that relate to the jurisdiction of the city comptroller. They issued independent reports which I published, which began to document the extent of the difficulty. I started to issue public warnings to the full extent of the knowledge and information. I had, as early as summer before last come to visit the Chairman of the Federal Reserve, the Chairman of the Council of Economic Advisers, to warn about what I saw as a coming crisis of this magnitude in municipal markets, generally, affecting New York City in particular.

Senator HELMS. What is your opinion of the reaction of the people of New York? Did they pay much attention to your warnings?

Mr. GOLDIN. I think you will recognize, Senator, that after a period of so many years, in which practices grew up, and become embedded into the system, that it took a period of educating the public to the extent of their danger, it took a period in which the impact needed to be documented and experienced before the full extent of the danger and the risk and catastrophe to the city was fully recognized as it is now fully recognized today.

Senator HELMS. I don't want to press you, but do you or do you not have an opinion as to whether there was a deliberate coverup?

Mr. GOLDIN. I think there is plenty of culpability to go around.

Senator HELMS. Are you saying yes or no?

Mr. GOLDIN. I don't think there was a deliberate coverup in the sense there was something illegal; no.

Senator HELMS. Do you think there was a deliberate coverup?

Mr. GOLDIN. I am enough of a lawyer, though I don't practice any more, to know that is a legal conclusion, relating to the nature and adequacy of evidence.

Senator HELMS. How much of New York City's debt is in bearer bonds?

Mr. GOLDIN. Most of it, about 85 percent.

Senator HELMS. I notice, if I have the figures correctly in mind, that about 34.8 percent of the city's budget is in welfare payments of one sort or another. Is that correct?

Mr. GOLDIN. That is budget, excluding debt service, Senator.

Senator HELMS. I understand that. 12.1, plus 14.1, plus 8.6 percent. Let me get back to the attitude of the people of New York City, sir. Mind you, the citizens of this country, outside of New York State and New York City, are watching very closely, and I must say to you, in all candor, that there is very little sympathy in North Carolina, outside of those holding some bearer bonds, that sort of thing.

You said a moment ago, I believe, that the garbage truck drivers walked off and left their trucks in the street?

Mr. GOLDIN. The radios reported they did that, when they didn't get paid.

Senator HELMS. I have heard Mr. Shanker on the television, and other people in public life. I am a bit intrigued. Is there no New York City spirit? Is nobody in New York willing to sacrifice to pull the city out of this hole?

Mr. GOLDIN. Yes, Senator, a lot of people are willing to sacrifice. I think the best evidence of that, Senator, is that already in just the few months remaining in this fiscal year, in light of the full recognition of the people of the city of New York, as to the realities of this situation, they are prepared to sustain \$200 million in budget cuts this year on the expense budget, and about \$160 million in capital budget cuts that are largely to finance our capital budget, very heavily finance current expense items in this fiscal year.

Senator HELMS. I beg your pardon. I am not talking about that. I am talking about your city employees, for example. Senator Garn, who sits to my right, pointed out yesterday that as the full-time mayor of Salt Lake City, Utah, he was paid \$19,000 a year, and he said, I cannot quote him precisely, but he said, in effect, that he finds it very difficult to have sympathy for a garbage collector who makes \$18,000 a year, yet who walks off the job when his city is in distress. Now to get back to my original question, is there no broad inclination among the employees and other citizens of New York City to bite the bullet and help pull themselves out of the hole? Are they going to continue to leave the garbage trucks in the street? Will the firemen sit in the fire stations and look to the Congress and say, bail us out? I have news for the city of New York. The Congress is not going to do it under the circumstances that now prevail, if I correctly read the public attitude around the country.

Mr. GOLDIN. Senator, if you permit me respectfully to respond, I would point out to you the fiscal plan now adopted for the next 3 years provides in the face of whatever inflationary or other pressures that may exist, No. 1, there is going to be a freeze on wages for all municipal employees. No. 2, there are going to have to be very substantial cutbacks in the level and extent of the municipal labor force, and that is accepted and understood. Obviously, we want to ameliorate the impact and hardship on individuals, but the labor force will have to be cut. Some of us, by way of leadership, have taken salary cuts on our own.

On January 1, 1974, I took a 10-percent voluntary cut. I would say to you, Senator, I think it may be understandable that, confronted suddenly, on a Friday morning, with the prospects that that afternoon a check that had been counted on for groceries, to meet a mortgage payment, for essential personal needs, will not be forthcoming, it

perhaps is not terribly difficult to understand why people would initially react with consternation. But the people of the city, including the public employees, have accepted the need for pain and sacrifice, and the evidence of it is in the forms I have described, cutbacks, salary curtailments, contraction of the labor force, and so forth.

Senator BROOKE. Would the Senator yield on that question?

Senator HELMS. Yes.

Senator BROOKE. According to the October 22, 1975, edition of the "Wall Street Journal," the head of the New York City Municipal Employees Union stated, "The wage freeze, which is an integral part of the city's 3-year austerity plan, would be illegal, and we know it can't be enforced." Is that true?

Mr. GOLDIN. That is one man's opinion, sir.

Senator BROOKE. Is it yours?

Mr. GOLDIN. No, sir; it is not.

Senator BROOKE. Does this freeze last beyond January?

Mr. GOLDIN. Yes, sir; it does. Under the new emergency financial control board plan adopted Monday night of this week, there is a 3-year freeze on all municipal salaries.

Senator BROOKE. If this is the attitude of the head of the New York City Municipal Employees Union, you are asking us to have confidence, based upon that, is that correct?

Mr. GOLDIN. I can understand, Senator, that in the face of the American tradition of people who lead the interests of select groups feeling that they need to be strong advocates for the position of their groups, that others outside would wonder about the sincerity of the concern. But sincerity of concern exists. Each group, within the context of the city is struggling to see how the cutbacks can be effected with the least adverse effect on their own group. The people are pulling together; as the cuts need to be made, all are accepting them. There may be some rhetoric, some purple comment, but I think the proof is emerging that the people are accepting the inevitable and are tightening their belts.

Senator BROOKE. I thank the Senator.

Senator HELMS. The Senator is welcome.

One final question.

Mr. Goldin, when was the mayor's committee on default organized?

Mr. GOLDIN. I believe, Senator, it was organized the end of last summer.

Senator HELMS. About 6 years too late, I would say. I have no more questions, Mr. Chairman.

Senator STEVENSON. First to finish the points raised by the Senator from Massachusetts, isn't it also true that the laws of New York require both the State and the city to maintain a balanced budget?

Mr. LEVITT. Yes, sir.

Senator STEVENSON. That is right with respect to both the State and the city now?

Mr. LEVITT. That is true.

Mr. GOLDIN. May I respond to that, Senator? The law heretofore has not defined what constitutes a balanced budget, and has legally permitted accounting gimmickry and other devices to achieve a so-called balanced budget acceptable in law that was not in fact a balanced budget that has now been completely changed.

Senator STEVENSON. Are you opining that the "gimmickry" was legal, all of it, in the city of New York?

Mr. GOLDIN. Yes, sir.

Senator STEVENSON. Gentlemen, this debate has assumed that we are faced with either of two propositions, a \$5 billion guarantee or nothing. That is not the case.

I am acting on the assumption that some action by the Federal Government is essential, and I think you have demonstrated that point in your testimony so far about the financial condition of both the city and the State.

The question is what kind of Federal assistance. And at this point, it seems to me we should all start with the stark realities, the facts, proof by the comptrollers that the city of New York is de facto bankrupt, that it cannot meet its obligations as they mature. And that, gentlemen, is the definition of insolvency.

Mr. RIFKIND. One definition.

Senator STEVENSON. By that definition, either the city or State could go into court.

Mr. RIFKIND. If there were a statute permitting it, they could.

Senator STEVENSON. Yes, and the bankruptcy statute, chapter 9, could be amended.

Mr. RIFKIND. It could be amended, yes.

Senator STEVENSON. It is a procedural question I think you are referring to. The procedures under the bankruptcy laws, which could, if necessary, with minor amendment, be made applicable in this case, are designed to permit the reorganization of municipalities and in fact have been used for that purpose.

Municipalities in the past have gone through reorganization. Never, as far as I am aware, has a municipality which has gone through reorganization failed afterwards to pay less than 100 percent on the dollar on all of its obligations.

That is not something that we are at this point suggesting, that default has to lead to a failure by the city or the State to pay 100 percent on all of its obligations.

Nor so far as I am aware is any member of this committee or the Congress suggesting that the Federal Government should sit by and not permit the city and the State to meet their obligations to the people of New York City.

There has been no suggestion that we should simply let that happen. That is a red herring, it is not in the cards. The Federal Government is not going to let that happen.

The question, as I see it, is how to prudently help New York City and State, how to do so in a way that restores public confidence, while protecting the integrity of the credit of the United States as well as the State and local governments that are affected and maintaining essential services.

To do that there are several possibilities, including default, and after default, such guarantees or other devices as are necessary to permit the continuation of services required by the people of New York; reorganization, consolidation of the citizen's debt, and as part of a plan of reorganization, some attention to the other causes of its other budgetary problems.

Now before we can make any sensible decision about which way to go, we have to know the facts. At the present time not all of the facts are available to us. Perhaps the best place to start is with the State's involvement in the finances of the city.

If I understood you correctly, Mr. Levitt, you said that the State would be unable to meet its obligations out of cash flow in November. Is that right, would it default in November?

Mr. LEVITT. We require borrowings from the bank in a sizable amount.

In November we need \$250 million to advance to the city. This is under the legislative appropriation. We have a commitment from New York State teachers retirement system of \$100 million. That leaves open a balance of \$150 million, which the members of the Governors staff are endeavoring to secure now.

In December, we require another \$250 million of borrowing, and then in the spring comes our huge customary tax anticipation borrowing, as to which we require substantial help from the banks and up to now, in this climate, have not been able to receive it.

Senator STEVENSON. Then the answer to the question is yes, the State cannot meet its obligations out of cash flow after some point in November.

Mr. LEVITT. Yes; that has been true in previous years.

Senator STEVENSON. I understand. It cannot get access to the market under present circumstances.

Mr. LEVITT. That is right.

Senator STEVENSON. Would you tell us the full extent to which the State has used its own credit for the benefit of the city? You mentioned, I believe, \$250 million worth of notes from the city to the State?

Mr. LEVITT. That is right.

Senator STEVENSON. What else is there? Could you describe the full extent of the financial relationship between the State and the city?

Mr. LEVITT. On April 14, 1975, I advanced to the city \$400 million of State aid for social services which it normally would be receiving around this time of the year.

On May 30, 1975, I advanced another \$200 million of the same type of social service state aid.

On June 11, 1975, I advanced to the city from the State treasury \$177 million of aid to education which normally it would receive later in the year.

On August 21, 1975, I advanced a further sum of \$120 million, social service State aid, making a total of \$897 million, which the city will not now be receiving, which it ordinarily would have received in due course.

Senator STEVENSON. What was the total again?

Mr. LEVITT. \$897 million. And that is exclusive of the \$250, and the \$500, the \$250 million—

Senator STEVENSON. And \$500 million in MAC notes and bonds?

Mr. LEVITT. The treasury made a \$750 million appropriation, first instance appropriation, payable in three installments.

The first installment was paid by me through borrowing from the banks at a rate of 8% for 1 year paper.

The second installment was made through my use of the retirement funds as a loan to the State government.

The third installment is yet to be made, and that is the one that we have the \$100 million committed from the teachers and need another \$150 million.

Senator STEVENSON. You are saying then to continue advancing payments to New York, \$890 million is required and that \$250 million in city notes is due in November, which cannot be paid.

Mr. LEVITT. State notes; \$250 million I have to borrow in November on revenue anticipation notes.

Senator STEVENSON. But that is because \$250 million in notes to the State could default. Is that right? You stand in the shoes of a creditor of the city?

Mr. LEVITT. These are first instance advances that the legislature has directed me to make to the city. They will be due and owing a year from now.

But I have to borrow it in order to make the advance.

Senator STEVENSON. You have to borrow to continue the advances for education, welfare, and so on? Are there city notes maturing in the near future held by the State?

Mr. LEVITT. Held by the State, no. We don't have any. Not by the State. These are held by banks and others.

Senator STEVENSON. Of the \$500 million in MAC obligations outstanding, what is the source of their payment?

Mr. LEVITT. The MAC obligations are supported by a pledge of the sales tax revenues for merely flowing to the city of New York, which now have been made State tax revenues.

They are supported also by the so-called moral commitments of the State, in quotes.

Senator STEVENSON. That is the 4-percent sales tax from the city?

Mr. LEVITT. It is a total of 8 percent, isn't it? Eight percent; four city, four State. The whole thing has now become a State tax. And that supports the bonds.

Senator STEVENSON. I see. Eight percent. And there is no other source except the moral obligation.

Mr. LEVITT. There is a stock transfer tax.

Mr. RIFKIND. As a secondary stream.

Mr. LEVITT. What is the coverage? 2 to 1.

Senator STEVENSON. Mr. Goldin, first I want to compliment you for the cash management procedures that I understand were adopted in the city comptroller's office some time ago, borrowed perhaps from the State treasurer of Illinois.

Mr. GOLDIN. That is correct, Senator.

Senator STEVENSON. I have no doubts about your cash management. But I do have some doubts about other matters within your jurisdiction.

The State very quickly furnished us with a compilation of all of the fund balances in the custody of the State comptroller. We have been seeking to obtain similar information from the city comptroller with respect to all of the account funds of the city, of related agencies, including special trust funds—Federal, State, as well as city—and we still don't have them.

I think the reason for seeking this information should be fairly obvious, especially after what the chairman said. We feel that we

have a right to have firsthand information about all of the financial resources of both the city and State before we act upon this request.

When are we going to get that financial statement from your office?

Mr. GOLDIN. Senator, unhappily, in the way in which the city is organized, for purposes of responding to your question, I have very limited jurisdiction.

I have undertaken to supply the committee and to the staff all of the information that would be under my jurisdiction as comptroller.

We have also, I might add in that connection, that relates to city treasury accounts, accounts in city agencies and departments, all cash under the jurisdiction of the city itself.

I have also undertaken, although I have no authority, to try and secure for the committee cash balance information respecting so-called covered organizations, quasi-independent organizations, and I supplied that information to the committee earlier, although I want to emphasize that that is not information, those are not accounts or records that are under my jurisdiction.

Senator STEVENSON. How do we get this information? How can we assess the situation in the city?

Mr. GOLDIN. The emergency financial control board has been undertaking to secure definitive information. We can give you information that is within certain parameters.

We can tell you roughly what the balances are, in all of the accounts of all of the independent agencies. I said earlier it is some \$275 million, including capital accounts and amounts available for the service of debt.

But I am unable to state definitely, based on the authority I have, what assets may be available in areas that do not lie within any jurisdiction, although the control board is seeking to assemble this material.

Senator STEVENSON. It is an incredible proposition for me to accept, to understand, to begin to understand, as one who has occupied a similar position. I don't think we can reasonably be called upon to act until we have that information, regardless of what the source is.

Mr. GOLDIN. If I may point out, Senator, Mr. Clifford, who journeyed to Illinois to study your system and designed the system for the city, to the extent we had the capability of modifying it for our own purposes, has pointed out to me that unlike the Illinois situation, where you were agents and trustees, for example, the State treasurer's agents and trustees for certain categories of funds, I am not in that position.

I am not an agent or trustee and have no authority respecting, for instance, the triborough authority funds.

Senator STEVENSON. I recognize that. I understand the limitations you are faced with. But I still think there ought to be a collective effort on the part of the responsible officials in the city to supply this information. And I understand that I am not the first to request this information, that others in the executive branch have been seeking it for many months now with no success.

Well, it had better be forthcoming because I know there are at least some members of this committee who are extremely reluctant to act until we know what the resources of the local government are.

Mr. GOLDIN. Senator, it might be interesting and useful to you to know that we have completed the design of a whole new accounting control and budgeting system for the city.

We hope to be able to begin to install that within a matter of months, and I have been asking and am asking the financial control board to assist us in that regard and I know they are sympathetic and I hope we will be able to have installed in relatively short order the kind of control and management system you would want us to have.

Senator STEVENSON. Mr. Chairman, I recognize my time has expired, but Senator Cranston indicated he would yield his time to me.

The CHAIRMAN. Yes. How much time is remaining?

Senator BROOKE. Would the Senator yield a moment?

We have all been very interested in getting the facts. One of the things that has concerned me—and I hope the Senator will pursue this—is I don't think we know exactly what New York City's demands will be, what its needs will be, and for how long they will need it.

This is what really disturbs me.

Is this just the first installment?

Are we going to be coming back in 3 years, 5 years?

This is what I really need to know, how much it will cost us, and for how long a period of time.

I hope we can get that.

Senator STEVENSON. That is just where I was going to move.

The CHAIRMAN. In fairness to Senator Garn, let me say that he is next, and Senator Stevenson's time is up.

Senator Garn has the floor.

Senator GARN. Thank you, Mr. Chairman.

Mr. Goldin, I would like to talk to you more about this 3-year salary freeze.

I understand you are continuing to be committed to that, as part of the solving of the financial problems.

Governor Carey has been here. We have heard witness after witness from New York and we have been rather disappointed in our hearings that they have been overwhelmingly stacked in favor, witnesses who are in favor of New York City.

We have not heard much of the other side.

Some of us on the committee have had to do our own digging outside of the committee hearings to hear other people on the bond market and so on.

That is neither here nor there.

Everybody in New York says we are going to take control, we will have reductions, layoffs, a 3-year wage freeze.

Senator Brooke, I understand, while I was out, quoted the head of the union, Mr. Gotbaum, who said the 3-year austerity plan would be illegal and it can't be enforced.

Let me put something else in the record by Gotbaum.

I was on a TV program with him Monday evening, another one rather stacked, a joint Washington-New York program, five people on from New York, one California Congressman with me in Washington in favor of New York, and there was me, 5 to 1. Not too bad a ratio.

But in response to a question about this austerity program, he went even further. He said on that program he would fight it to the death.

Now, if that is the kind of cooperation you have got going on there, how can you guarantee this committee that your austerity program is going to work?

He was asked what do you mean to the death. He really didn't explain it. But that is a very strong statement.

If your unions, which in my opinion are the major cause of the problem, along with the gutless politicians I mentioned last week, if that is the attitude that they have, tell me how you are going to enforce this austerity program that you and others have said will be a guarantee for us.

Mr. GOLDIN. Senator, whatever the language and assertions may be, if you will permit me, I would like to recapitulate some of the essential facts.

No. 1, Mr. Gotbaum was the first labor leader to agree to a wage freeze on a voluntary basis last summer.

No. 2, Mr. Gotbaum was the head of the largest employee union in the city. He is an important trustee of the largest of the pension systems, has voted in favor of permitting investments by these pension systems in obligations either of the city or in obligations of the MAC.

No. 3, Mr. Gotbaum knows that the requirement of the law is—whatever the gutless politicians might or might not wish under other circumstances—for the city budget to be balanced by fiscal 1977-78, within 21 months, and for substantial progress to be made toward that this very fiscal year.

Next, Mr. Gotbaum knows we have adopted a program requiring \$200 million in cuts on an annualized basis this very fiscal year. Whatever the pain may be. Whatever their reaction may be. I think the fact—not in the past, Senator, to be sure, not the history, but the recent and contemporaneous facts, showing the direction in which the city is moving, its willingness to tighten its belt and take tough steps speaks louder than anything else.

Senator GARN. That may be well true, the history of what Mr. Gotbaum has done. But yesterday he made a statement it was illegal, could not be enforced, and Monday night on public TV said he would fight it to the death.

Mr. RIFKIND. May I answer your question briefly?

Senator GARN. Yes, sir.

Mr. RIFKIND. I think we tend to forget that the city of New York is operating on an entirely new city charter in effect.

The city is being run by a State agency called the emergency financial control board. I know something about it because I wrote the legislation creating it, and such legislation has teeth in it.

The first tooth in it is that the city no longer estimates revenues because people previously overestimated revenues and then bundled expenses against that optimistic estimate.

That is out.

The city cannot borrow without the consent of the board, and the city may not spend without the approval of the board. The city may not enter into a contract without the board's approval.

This board consists of three businessmen, the Governor, Mr. Levitt, Mr. Goldin and the mayor.

Now, you have an entirely new bunch of watchdogs watching the treasury.

Senator GARN. I understand that. But regardless of who the watchdogs are, if they decide their fight to the death means a general strike, do you have the authority to prevent that?

You have had strikes there before. I have seen the garbage pile up there.

Tell me how you control the labor unions. You can control the budget, maybe.

Mr. RIFKIND. If you can tell me how you control them in your jurisdiction, I will tell you how we will control them.

Senator GARN. I would fire them when they struck. That is the difference between guts and people who yield to them year after year.

Mr. RIFKIND. The board members are ready to get tough.

Senator GARN. I hope so. I wonder if you can come through. I don't question your sincerity or intent, but I wonder about the ability to control that kind of a situation.

Mr. Levitt mentioned the fiduciary capacity. May I say I admire your stand and I agree with your protection of those pension funds. Over and over again we hear that New York is willing to put their money where their mouth is. You are not willing to take the risk in that fund.

Maybe you are entirely right, but you are willing to come here and say, look Governor Carey—

Mr. LEVITT. Sir, if this was my money I would take the risk. But I am a fiduciary.

Senator GARN. I am a fiduciary for the taxpayers of this country.

Mr. LEVITT. I am not speaking of fiduciary responsibility to the taxpayers. I am speaking of fiduciary responsibility to 600,000 State employees, and to the 100-odd thousand who are retired.

These are funds that I hold in trust to make certain that they can retire in peace and comfort and dignity.

I am bound, therefore, by purely investment criteria. And no one should ask me to violate that obligation.

Senator GARN. I agree. And I respect you for that.

But you have just made my point. You are judging it on investment criteria, but we are constantly assured by officials from New York there will be no problem, no cost to the Federal Government.

If they really mean that, then some of the New York funds ought to be used.

But I agree with you, I think your judging on investment criteria is not going to work. It won't work for the feds. And I have a fiduciary relationship. But I recognize the Congress is not normally as responsible as you are. So they might be more likely to bail you out.

Senator Brooke asked you about these bonds of Maryland and Georgia. And there are a lot of other issues in the last few months all over the country that have been going at very low rates, lower than normal, with cities that are well managed and with very good performance records.

I understand your comment was that the lenders were looking to the Congress for fiscal sanity, and loaning on that basis.

Sir, I just can't accept the lenders are looking to the Congress for fiscal sanity.

Mr. LEVITT. Senator, those are not my words, nor was it my intent.

I said at that time the climate, the investment climate is somewhat ameliorated in recent weeks. It was almost approaching the point of panic in the municipal bond market just a short time ago and they were loath to invest in any municipal obligation.

With the passing of time, and I think our emergency financial control board has made a notable contribution to this amelioration of climate.

Here, as Judge Rifkind pointed out, we have an organization that will impose real fiscal discipline on the city of New York. This plus the expectation, I think pretty broadly felt—I know Senator Brooke disagrees with me—the expectation that the Federal Establishment cannot let the city of New York go into default, has created a climate in the municipal bond market that has favored those who have come to market yesterday and the day before.

Senator GARN. It has been over a period of several weeks there have been good bond sales around the country.

Mr. LEVITT. Not really, not to the extent manifested by the Maryland sale.

Senator GARN. I can't believe these lenders would be basing any loaning decision on the expectation of what Congress may or may not do.

Mr. LEVITT. Senator, I couldn't believe the sophisticated New York banks, the giants, would refuse to lend the State of New York any amount of money on the kinds of security I described earlier in this hearing, where there is absolutely no possibility of a loss.

I couldn't believe that. And yet they did. They refused. They turned me down.

I got down to the point of begging for a \$10 million participation and they said no. I couldn't believe that. I think they will regret that when I show a big profit on that \$250 million note issue, as I will. You just watch this.

Senator GARN. All I can say is I hope you gentlemen are right. I hope you can do what you say you can as far as the fiscal responsibility and so on. I really hope that.

At this point I can't be convinced on what we have been told, that the Senator from Utah should be involved in bailing out the kinds of fiscal irresponsibility that has gone on in the past where most of the cities in the country have been well managed and have mayors and city councilmen who have nerve and have the word "no" in their vocabulary. But I respect your intentions.

The CHAIRMAN. Senator Biden.

Senator BIDEN. I will take 2 minutes and then yield the rest of my time to Senator Stevenson.

Gentlemen, it seems to me that there are several basic questions. The first is who are we bailing out, if we bail anybody out. Are we bailing out the citizens of New York City or the holders of the paper?

That is the first question that I think the committee has to address.

The second question, it seems to me, is in order for us to decide what course of action we are going to take in this committee, it is necessary for us to make our own independent assessment as to what the ripple effect, if any, will be of our bailing or not bailing out.

I spoke to a group of bankers and investors at a meeting in Pennsylvania on Monday. Their feeling was that as time went on, and it

became apparent that the mood of the Congress was not to help New York City by bailing out the investors, that the bond market would solidify.

I think if the Maryland situation can be used as much to argue their point as it is being used by you, that the more apparent it becomes that there will be no massive congressional help, the more sound the bond market will become, and the hysteria will in fact diminish.

The third thing I think we have to figure beyond the ripple effect is the question of the extent of your problem; and then where the responsibility lies.

It seems to me we would all agree on this committee that first the city has an obligation to exhaust its remedies and then the State, and only then the Federal Government.

And in order to do that, we have to get what I think Senator Stevenson was trying to reach, the question of what the combined total available resources of the city of New York are and in turn, after determining that, what they in the State of New York's are, and then whether or not we want to get in, based on what those resources are.

I sympathize with the comptroller of the city and the State, particularly the city. He probably wakes up nights in a cold sweat wondering, My God, why did I run, what did I inherit? But I think there would be some feeling in New York City that we all better get together overnight, not, you know, next week, but overnight. You know, let's meet in Madison Square Garden if need be and let's compile it for the White House, Senator Stevenson, and the committee, and others looking for the information.

Lastly, just in the last three weeks I have been in 11 States or 12 States, on speaking engagements where there were in excess of a thousand people and ranging from Arizona, Nevada, California, all of the way to Pennsylvania, New Jersey, and Delaware. And, gentlemen as they say in the southern part of my State, you all ain't traveling the same place as I have been traveling, because there isn't any feeling of goodwill toward New York City. I have not run across a single solitary instance, other than someone involved in the investment community, where there is anything resembling a groundswell of support for New York City.

As a matter of fact in my little old State of Delaware the major radio programs are running a campaign, announcing my phone number over the radio, because I am on this committee, saying call Biden and tell him what you think about bailing out New York, and they are calling in and telling me. I can't recall anybody calling and telling me to bail out New York.

I say that not as to what course of action we should take because I don't think we should be guided by that, but I think you are kidding yourselves if you think there is some national sentiment beyond your state. I made several phone calls today to upstate New York and there is not a lot of good feeling there either.

But it seems to me there isn't the kind of sentiment you all anticipate.

And, lastly, and then I yield, I wonder whether or not New York ever thought they would have to rely on two votes from North Carolina to save themselves. I find that one of the most amusing things I have run across since I have been in the Senate, to think that Mr.

Morgan and Mr. Helms, both Senators from North Carolina, would have to help determine the fate of the city of New York. I don't know what it means, but I find it ironic.

I yield.

Mr. RIFKIND. May I answer one question in a short sentence?

You put the question this way: Whom are we bailing out, the bankers, bondholders, and so on.

My answer is we are bailing nobody out. As one of the committee members indicated, the history shows that when cities do default, ultimately the bondholders get paid. I have no doubt they will be paid, but they will be paid after a period of stress, strain, and social disorder which will be very costly to the United States.

Now the reason that the people in the communities you visited are not interested is because they are looking at it just that way, are we going to bail out the city of New York. I don't believe there has been a single representative from the city of New York who has asked the Congress to bail it out. Nobody has asked for a loan. They have asked for a guaranty of credit; the thing that is invariably the instrument of recovery when there is a cash flow problem.

I would say to Senator Stevenson that I do not believe the city of New York is insolvent in the normal sense of the word.

The people of the city are not insolvent, they are sending billions of dollars in taxes to the U.S. Treasury. It is a cash flow problem, and credit, since the Phoenicians invented money, has been the method by which cash flow problems have been solved.

The city needs a 3-year bridge in which to solve its problem of cash flow. And the United States has been asked to guarantee it, and if they put it on a taxable basis, the United States will be getting \$500 million a year, which is very good security, because they will collect taxes on the bond interest, the premium, and they also have the money that is now going to the city by way of revenue sharing.

Senator BIDEN. Your Honor, I have tremendous respect for you as a jurist, your career is one of the most distinguished in this century, and I really mean that. But the gentleman sitting to your right had to make a judgment decision based on investment criteria, and he tells us the criteria are such that it is not likely you will have that return that you are telling us we are going to make, and we are sitting here making an investment decision, the same decision he made, or that he could not make because of his fiduciary responsibility, and we are asked to do it.

Mr. LEVITT. Senator, that is not your decision at all, if you will forgive me. May I suggest when the people in Delaware call you up to ask you about this situation, you acquaint them with what you know will be the consequences of default by the city of New York, the consequences on a national scale.

Senator BIDEN. That is what I tried to do, that is why I talk about the ripple effect. I am not convinced it is there.

Mr. LEVITT. Assume in the State of New York, come this spring, I am not able to borrow this \$4 billion I require to give welfare assistance and the welfare centers are obliged to close in the city of New York because of a lack of funds.

What do you suppose will happen? Is this not a matter of Federal concern, what happens under those circumstances?

Senator BIDEN. Sure it is, Mr. Comptroller. I concur fully with Senator Stevenson. There is no way I am going to sit on this committee in the U.S. Senate and not in fact deal with the needs of the people of New York City. The question is the mechanism by which we do it, whether we do it before or after the fact of a bankruptcy.

Mr. LEVITT. As to the mechanism, let me pinpoint one more factor. This solution, if it is going to be solved at all, has to be based upon a return to viability of the city of New York. This has to be the ultimate goal. Any modeling which does not achieve that end will fail in its purpose. I ask you to bear that in mind in considering these various alternatives.

Senator BIDEN. I really want to pursue this more, but Senator Stevenson is more knowledgeable in this area than I am, he was addressing a significant line of questioning, and the 30 seconds I have left, whatever it is, I yield.

The CHAIRMAN. Senator Stevenson has whatever time Senator Biden has remaining. Go ahead.

The CLERK. One minute.

Senator STEVENSON. Gentlemen, we all agree on the objective, if we cannot come up with something defensible and this \$5 billion guarantee proposal is not defensible—the Federal Government will end up aiding New York by sending in the troops.

That is what we are up against, and we understand that.

Now in 30 seconds I can't very well begin a whole line of inquiry.

Senator MCINTYRE. I have 4 minutes. You can have that.

Senator STEVENSON. Thank you. To clean up a couple of loose ends: I am not sure the record makes it clear whether the city does or does not owe the State any money? Was the answer to that no, it does not?

Mr. LEVITT. No. As a matter of fact this \$250 million I just mentioned was a loan to the State of New York and the State made a first instance advance to the city. That means in the first instance it is advanced to the city, but the city has to repay that.

As a matter of fact, I hold a contract providing the terms of the repayment.

Senator STEVENSON. Is that all, the \$250 million?

Mr. LEVITT. There will be more. As of now it is \$500 million.

Senator STEVENSON. How much is there that will come due?

Mr. LEVITT. There is another \$250 million that will come due in November. We have to advance in November.

Senator STEVENSON. How much in total is there?

Mr. LEVITT. \$750 million.

Senator STEVENSON. \$750 million advanced by the State that must be repaid by the city?

Mr. LEVITT. Bear in mind I made advances in State aid out of turn, so this in a sense is an obligation, too. They won't get the State aid when it is normally due.

Senator STEVENSON. I understand. I am trying to zero in on the \$750 million that was advanced by the State, with some apparently binding obligation to repay it. When is all of that \$500 million due to be repaid?

Mr. LEVITT. One year from the date of advance. In the case of the \$250 million that I made from the retirement system to the city, that

will be due next October. For that I hold security, as I described earlier.

Senator STEVENSON. Would you also tell us, Mr. Goldin, what the demonstrations are of all of the city obligations, notes, bonds, and so on?

Mr. GOLDIN. Just to make sure I understand your question, although I don't have the information with me, are you asking me respecting all of the city's outstanding debt, the size of the instruments that have been issued?

Senator STEVENSON. The size of the instruments.

Mr. GOLDIN. I will try to get that for you, sir.

Senator STEVENSON. Can you tell us off hand what the smallest is?

Mr. GOLDIN. Yes, I can, in general our long-term obligations have historically been issued in minimum denominations of \$5,000. Our short-term obligations were, until last year, issued in minimum denominations of \$25,000. We reduced that as part of an announced program to reduce it even further, initially to \$10,000 minimum, we had planned to go beyond that, but we were foreclosed from the market.

Senator STEVENSON. I asked that for what I imagine to you is an obvious reason. We are not just talking about bailing out the widows and orphans, probably not many of them have \$10,000 invested in short-term notes. And that is a critical concern up here, who are we bailing out. Are we bailing out the banks, including some of the culprits, the architects of this mess, including speculators, who are buying 10 percent New York City tax free notes at a 60 percent discount for an effective rate of 20 percent.

Mr. GOLDIN. If you will permit me, Senator, we can't answer that definitively, because as I said most of our paper is issued in bearer form.

But if you would have come to my office last Friday afternoon, when there was a risk of default, and had seen the lines of people who were there to collect on their own accounts, you would have recognized that whatever the specific numbers may be, there are clearly many, many people, who by no reasonable definition, can be defined as rich, who are holders of New York City obligations and whose lives would be very severely disrupted, just from looking at the line and talking to them, if we were to default.

Senator STEVENSON. Believe me, I have identified a number of them too, they have been on the telephone with me, and they aren't widows and orphans.

Now, getting back to the cash flow projections which you testified to. As I understand it, by the end of March the operating deficit exclusive of all debt service, would amount to about \$1.2 billion, is that correct?

Mr. GOLDIN. Yes, that is correct, Senator.

Senator STEVENSON. That is exclusive of all debt service, principal, and interest?

Mr. GOLDIN. It includes MAC take out, but does not include direct city debt service.

Senator STEVENSON. What happens in April, assuming normal tax payments?

In other words, let's leave out for the moment that imponderable you mentioned about nonpayment of real estate taxes.

Mr. GOLDIN. We tend to be heavier collectors of revenue during the last quarter of the year, Senator. So, on balance, it would net out to about \$750 million during the balance of the year for the year.

Senator STEVENSON. Net out—let me be sure I understand that. I have a figure which comes out differently. Operating surplus in April, May, and June of \$525 million, for a net deficit by the end of June of \$481 million, exclusive of debt service. Are you giving me a different net figure?

Mr. CLIFFORD. I think the difference, Senator, is the MAC takeout.

Mr. GOLDIN. Whether or not you included the MAC takeout, some of the figures have not recognized the city will not be able, even if it were to default, to avoid payment of debt service on MAC, because those revenues do not come to the city prior to the deduction of amounts necessary to serve the MAC debt.

Mr. LEVITT. I get them.

Senator STEVENSON. As I understand it, the city doesn't have an obligation to pay the obligations of MAC, it has already forfeited its half of the sales tax?

Mr. GOLDIN. The revenues no longer flow directly to the city, Senator, so debt that might at one time have been issued by the city, for which city revenues would have, provided debt service, is no longer issued by the city. The debt service payments no longer come into the city's hands, they are deducted by the State and then the balance, whatever may be left, is remitted to us.

Senator STEVENSON. What was the aggregate figure by the end of June that you gave?

Mr. GOLDIN. Roughly \$750 million.

Senator STEVENSON. \$750 million. And that assumes nonreceipt of your share of the sales tax?

Mr. GOLDIN. That assumes the MAC takeout. That is correct. It is no longer our sales tax.

Senator STEVENSON. Now—

The CHAIRMAN. The Senator's time has expired again.

Senator STEVENSON. This is an impossible process.

The CHAIRMAN. We will come back to you, Senator. Senator Eagleton has been patiently waiting. He has asked some very helpful questions in the previous hearings. Can we get unanimous consent to permit Senator Eagleton to ask a question? Go ahead.

Senator EAGLETON. Last Saturday Mr. Walter Wriston, the president of First National City Bank of New York testified, Senator Brooke asked him two questions in succession, the thrust of which was, why the banks of New York didn't get onto this situation sooner. Mr. Wriston answer that, yes, they were familiar with some of the gimmicks, but they didn't know all of them, they didn't have access to the books. Then Senator Brooke followed up and said, "You don't lend money to private borrowers under those same conditons." Mr. Wriston replied, when the the mayor of New York and the comptroller of New York submit figures, the banks of New York had "a certain right" to rely on those figures. I ask you, Mr. Levitt, based on your 20 years of contacts with New York banks, do you think the New York banks acted prudently in their condoning and, in a sense, participation in the financial demise of the city of New York?

Mr. LEVITT. Senator, I have talked to these bankers in recent weeks and I have told them in my judgment they did not act in accordance with the tradition of commercial banking in the State of New York. I reminded them of the long history of help and assistance that the banking system of New York State has rendered governments, State and local. And I said to them, why did you permit, as lenders, why did you permit the city to persist in practices which were highly imprudent? Why did you not sit them down when they came for renewals of loans and ask the pertinent questions in much the same manner you would ask a private lender? And the answer I got from most of them was, we cannot deal with government in the same manner that we deal with private borrowers.

My reply to that was, this is absolutely wrong, that banking, the bank fraternity owes to the government the obligation of seeing to it to the best of their ability that the city or the State, as the case may be, follows prudent lending practices. To that end they should acquaint themselves with the fiscal affairs of the city or the State, as the case may be, as they do frequently by conversation with the appropriate public officials, and decline to make loans that they consider imprudent or unsound.

Mr. GOLDIN. Mr. Chairman, May I add a word to the Senator? It may be useful for you to know, Senator, that 7 months after I came into office, upon the completion of the detailed, exhaustive examination of the recordingkeeping, accounts, assets, and related matters under the jurisdiction of the comptroller, I issued three independent CPA reports, which widely disseminated essential information with respect to the reliability and completeness of information, and from that point forward in the summer of 1974 the world was on notice as to the status of the situation.

Mr. LEVITT. And prior to that the world was on notice from audits performed by my office since 1971, what the situation was affecting the city of New York. So the banks and anyone else had access to plenty of information that would have alerted them to this situation.

The CHAIRMAN. Senator Javits has also been very patient and obviously has a deep interest in this.

With the committee's permission, he may ask questions.

Senator JAVITS. Thank you, Mr. Chairman.

Mr. Levitt, a great point has been made about your exercise of judgment as a fiduciary in the acquisition of these securities which are under discussion, or the trust funds of which you are the trustee. I would like to put that in focus, if I can.

Because of your role as a trustee, it seems to me decisive that we understand the difference between what you have done and what we ask the United States to do. As I understand, you were asked to invest cash and to take an obligation, with the possibility of some form of default procedure which might even make it come due a longer time hence at a lesser rate of interest. You have 100,000 retirees and other people retiring every day from the State service.

Therefore, as I understood it, your fiduciary obligation related to that kind of need, which is for a steady flow of cash in the market, so you could sell the securities if you needed the cash. The United States is asked to undertake a bridge guarantee for 3 years, in a situation

where history, even the depression, showed that no money was ultimately lost, and where, if the United States were called upon to make good on its guarantee, it would not pay cash, but it would under the FHA provisions, which undoubtedly will be rolled into this bill, issue long-term bonds. Now, are those two in your financial judgment, opposite, or parallel decisions?

Mr. LEVITT. No; in addition to the circumstances you mention, in addition to my best judgment as to the propriety of further investment in MAC bonds, I had the unanimous view of my advisory committee that I should not invest further in MAC obligations.

Senator JAVITS. I have one other question I would like to ask you and the comptroller both. Both of you have given such nonhesitant answers. New York State, insofar as what we are talking about, is big business. Do you estimate the assets of New York City to be in excess of the bonded debt of the State and the city, the bonded debt, as I understand it, of the city alone is something between \$13 and \$14 billion, and the bonded state of the State is how much, Mr. Levitt?

Mr. LEVITT. Well, we have two kinds of debt—

Senator JAVITS. Give us both.

Mr. LEVITT. The full faith and credit is the only kind I recognize. That is between \$600 and \$700 billion. And we have the moral commitments, which range over \$9 billion.

Senator JAVITS. So the total sum is \$29 billion, correct?

Mr. LEVITT. I object to including the moral commitments.

Senator JAVITS. Including it, sir. I only ask you to check the figures. What do you estimate New York State to be worth in its asset value?

Mr. LEVITT. You will have to give me a little time to make that computation, sir.

Senator JAVITS. Is it at least three, four, or five times the bonded debt?

Mr. LEVITT. I would say so, yes, sir.

Senator JAVITS. What do you say about the city, those \$14 billion? What is New York's assessed real estate?

Mr. GOLDIN. The total evaluation of our bonded indebtedness is \$6.5 billion and the total valuation of the real estate alone is \$80 billion.

Senator JAVITS. Now, gentlemen, I would like to ask you one other question, as those seem to be so clear. The largest American corporation is American Telephone & Telegraph Co. It has \$67 billion in assets, and \$23 billion in operating revenues, which is pretty much like the city and State, which have about \$23 billion in operating revenues. What is your financial judgment as to the impact upon the American economy if A.T. & T. went bust?

Mr. LEVITT. Very bad, sir.

Senator JAVITS. What would it do to our markets, to your employment, what would it do to our recovery in your financial judgment?

Mr. LEVITT. The question answers itself. I think it would be disastrous.

Senator JAVITS. What do you say, Mr. Goldin?

Mr. GOLDIN. Catastrophic, Senator.

Senator JAVITS. Thank you.

The CHAIRMAN. Gentlemen, I will try to be as quick as I can on this, but you are a very, very helpful panel, and I think you are making a fine record that is most useful to us. Senator Biden has made a

point that has been recurring consistently, and as you might expect, we hear more of it in the cloakroom than in the hearings, perhaps, and it is a fundamental point. That is what is really the attitude of the people of the country about this. You give us one view; others give another view. I saw a poll not long ago, the only poll I have seen on whether or not the Federal Government should assist New York. It was favorable and I was shocked and surprised; it was hard to believe. I called up the agency that made the poll and checked it out. I then went to the principal polling agencies in the country. I called Gallup, Roper, and Harris and I asked each of them if they made a poll. Gallup made no poll. Roper made a poll, not on New York, but the problems of the cities. Harris had made a poll. And it seems to me that really indicates what the attitude of the people of the country is.

To me, it was very revealing. The way the attitude on how New York has conducted its business is one thing, what the Federal Government should do now is quite something else.

Let me read a couple of questions as they were asked the people.

"With over 300,000 city employees, New York City is a bureaucracy out of control. Agree or disagree."

Agreed, 61 percent; disagree, 13 percent.

The second question, and this was a statement, "The unions and municipal employees of New York have won such high wages, such high pensions, and such liberal working conditions it is no wonder New York City is going broke."

Agree, 58 percent, disagree, 19 percent. Overwhelming.

The third assertion, "There are just too many political hacks on the payroll in New York City who do little more than collect pay without much work."

Agree, 68 percent; disagree, only 5 percent.

Then the fourth assertion, "New York City and other large cities are going to be in real financial trouble until they cut out graft and corruption and until municipal unions make more moderate demands."

Agree, 70 percent; disagree, 7 percent; 10 to 1 overwhelming.

But then, "New York City pays much more in the way of Federal taxes than other areas, and it is not right that the Federal Government does not give New York more money in its current financial crisis."

Agree, 35; disagree, 29 percent.

But the final question was "New York City and other cities are more business and cultural centers and must be kept from going bankrupt."

Agree, 65 percent; disagree, 12 percent. Again, overwhelming, 5 to 1, recognizing that New York has gotten into all kinds of trouble, that they are continuing to be in difficulty; nevertheless, you have got that emphatic reaction from a highly reputable polling agency.

I might say that the question, the poll which I first mentioned was, "Suppose New York's financial troubles get worse and the city is in danger of going bankrupt. Do you think the Federal Government should or should not step in with financial assistance to New York City to prevent this from happening?"

Yes, 51 percent; no, 31; no opinion, 15 percent; under certain conditions, 5 percent. Again, if you add with some conditions, 56 percent, yes; 31 percent, no.

So I think that we may be missing a point. There are a lot of hostilities, a lot of criticisms, a lot of convictions that New York has been

badly run. There is also, it seems, on the basis of reputable polling opinion, that New York should not be permitted to go bankrupt, should not be permitted to default. Now I would like to ask Mr. Goldin this question, and I would like Mr. Levitt to comment on it, too.

The Senator from Illinois, Senator Stevenson, said that the shortfall in essential services for New York in the event of default, that is the picture we painted in the opening remarks, the possibilities of schools closing and so forth, was a red herring, it would never happen because after New York defaults, the Federal Government would step in to assure essential services.

I would like to ask you, Mr. Goldin, if you could give us as specifically as possible—and I realize this is difficult and speculative, and this is the issue we have to decide tomorrow—would you compare the consequences in terms of cost to the Federal Government of letting New York default and then acting to sustain services on one hand, and the guarantee approach we have discussed, on the other—

Senator STEVENSON. Mr. Chairman, if you will yield, that is not what I am suggesting at all.

The CHAIRMAN. If you don't mind, it is my time; I would like to ask the question.

Mr. GOLDIN. Mr. Chairman, for those Senators for whom the issue is framed in terms of the option of a limited guarantee of limited duration, or the possibility of direct help to the city in the aftermath of a possible default, it seems to me the parameters are quite clear. New York City is able to develop a definitive plan to work out of its present problems, with Federal help in the form of a guarantee for a 3-year period, that would not have to exceed \$5.8 billion. At the same time, if we were to default, and were not to pay any debt service, our shortfall this year in operating cash for essential services, without paying any principal or interest this year alone would be \$1.2 billion; next year, it would be a minimum of \$1.4 billion, and based on the probabilities of declines in real estate revenue, other erosions of the tax base, could decline precipitously thereafter. So, on the one hand, there is a guarantee with a plan based on numbers that can be examined, verified, that have to be vindicated because of the requirements of law; that is, of limited duration and limited amount.

On the other hand, there is a potential massive annual shortfall in the availability of cash for police, fire, sanitation, health, hospital, education, and other services that would be virtually never ending. In that context, Mr. Chairman, and members of the committee, I would like to emphasize for you that the plan that has been worked out as a possible option, as one alternative for consideration by the committee, by its effective and professional staff, would provide the beginning of a workout for the city, within a matter of 3 years, whereas the interminability of the unavailability of credit to the city for essential capital purposes, to keep body and soul together, it seems to me makes the specter of it not being able to secure credit for the long term, one that is absolutely monstrous.

#### EVENING SESSION

The CHAIRMAN. I think Senator Stevenson was right in objecting to the way I framed the question. Let me see if I can come closer. Supposing we kept what the statement has done in place, the people have

done an excellent job, I think, they have reduced services, they have made some progress and give promise of making more. Supposing in addition we provided the Federal loan that had the toughest kinds of policing, to make sure it was administered efficiently, and not excessive, but it came after default. Would this modify your response in any way?

MR. GOLDIN. I think the very serious problem with that, Senator, is in the aftermath of default, the consequences to the city, and you will forgive me if for a moment I am parochial and don't consider the ripple effects on the rest of the country, but the consequences to the city could be so enormous so, as a matter of fact of public policies, it would seem to me a committee of the Congress, which wanted to extend limited help in defined form, that did not take the form of direct cash advances, would wish to assist the city to recover and to be able to secure credit once again on its own; letting the city experience default would foreclose the credit that might otherwise be available to the city for a long time.

During the years I practiced law, I worked extensively on legal investment statutes, in connection with the largest industrial firm in the country, and those statutes in many jurisdictions are so specific and so detailed that it would be clear that the credit markets would have to be closed to the city under those circumstances for a very long time, and that doesn't need to be. If the help of a limited and defined kind is provided to us based on strict requirements, based on a plan in advance.

THE CHAIRMAN. What you are saying is if we follow the guarantee route, New York will be able to get back into the credit markets, you feel within 3 or 4 years; if we follow the route of permitting New York to default, there is no telling how long, it may be 5 or 6 years, it may be 10 years, it may be many years beyond that. Is that correct?

MR. GOLDIN. Yes.

THE CHAIRMAN. Now, let me ask. Mr. Levitt to tell us what happens to the State of New York on the one hand if we follow the program of permitting default and then moving in as helpfully as possible to assist it?

MR. LEVITT. I think the consequences of default are horrendous, I think they are too horrible to contemplate.

THE CHAIRMAN. Can you be specific in terms of cost?

MR. LEVITT. The cost consequences are incalculable. I think the cost consequences on the Federal Government itself would be huge.

THE CHAIRMAN. Would the Federal Government have to loan that \$3½ billion for you next spring, that you talked about?

MR. LEVITT. I don't know where I would get that money. Somebody would have to supply it, or the localities, the schools—

THE CHAIRMAN. For how long would the Federal Government have to be in the business of loaning money to New York?

MR. LEVITT. There is really no telling about that, I don't know the answer to that.

THE CHAIRMAN. Do you think it would be many years?

MR. LEVITT. I am afraid it would be. I think it would be a very sad thing. What I was going to suggest, Mr. Chairman, is that if in the wisdom of this Congress a Federal guarantee is imposed, I

would urge that there be considered the insertion of a Federal presence on the governing body that supervises the fiscal affairs of the city of New York, in order to strengthen the feeling of confidence on the part of the investment community in the affairs of the city, then the fiscal affairs are truly under control.

The CHAIRMAN. Let me conclude by asking, Mr. Axelson, you have been very quiet, we know you are an extraordinarily able man, you have a position of great responsibility with respect to the fiscal affairs of your city. I would like to ask you, I think you have a table that the staff made available for you, and I think that table has been made available to Mr. Clifford and Mr. Goldin and I hope it can be made available to Mr. Levitt also. The staff has put together all of the data that they could with respect to debt rollover, deficit including debt service, but not capital, capital program, and the effects of this data. I want to know whether or not in your judgment on the basis of the evidence that you have, this table is accurate and correct and the committee can rely on that when we mark up the bill tomorrow.

Mr. AXELSON. Yes indeed, I believe it is a very excellent portrayal. I would just like to comment a moment on it to draw your attention to the magnitude of the numbers there. On the righthand side it shows the total dollars which total a peak borrowing of \$9 billion. Now, it is contemplated that with a Federal guarantee on a portion of the debt that the city would have to incur, that it would be possible to secure the seasonal financing of the city, that which would be borrowed temporary, and the flow of tax revenues, from commercial sources, and that therefore that \$2 billion of the \$9 billion would be financed in the private sector. It is also contemplated that \$1 billion of the remaining \$7 billion could be financed in the private sector and, as I understand it, the concept of the bill, which is before you, would provide something of that general magnitude, 20 percent of the total. That is how the number becomes \$6 billion and the question was asked during the session today what is the number, is it 5, 6, 7 or 9. Now if I may, Senator, I would like to make one other observation. I am a 5-week-old deputy mayor of New York City, and I would like to comment on what has been discussed here from a very different point of view. That is the point of view of the management task facing the administration of a city to deal with the problems immediately at hand.

I am not a municipal finance expert in terms of knowing the markets and I won't even make any comments in that area. That has been explored very thoroughly. But what has not been explored is the management capacity of the administration of New York City to carry out the arrangements that are required under the financial plan. You had described to you the magnitude of the cuts in expenses that have to be incurred, the magnitude of the layoffs that will have to be made, in order to reduce the city budget by \$724 million a year in the next 20 months. That really is an enormous undertaking. I would hope that nothing will seriously divert the attention of the managements of the city to getting on with that task. Whether we default or we don't default, we have got to get on with that task. It has already been mentioned here that one way or another, the Federal Government is going to have to do something for New York City. It is only a question of form and timing, if I understand what seems to be a general con-

sensus. If we went through default, we would be going down a brand new road, there would be many uncertainties. There would probably be a jillion lawsuits, we would have enormous diversion of effort of the senior management officers of New York City and I think that would work very much to the detriment of carrying out the task we are all devoted to here.

I would hope that default wouldn't divert us from that task and it would not end up that we were unable to carry out our mission here because we were so consumed by the role of events that default would bring on.

The CHAIRMAN. Gentlemen, my time is up. I would appreciate it, however, if Mr. Goldin and also Mr. Levitt could tell me whether or not this table is accurate.

Mr. GOLDIN. Mr. Chairman, the numbers are excellent and I want to compliment Mr. McLean, Mr. Weintraub, Mr. Pardes, the other members of the staff for having done an extraordinary job in putting them together. I would call your attention particularly to the workout cards based on those numbers, which, I think, represent a creative effort as an option for this committee.

The CHAIRMAN. To say that one missing link here is the figure that, a very important figure that Senator Stevenson has been working so hard to get, and the funds bills.

Mr. GOLDIN. I think the Senator is entitled to that.

The CHAIRMAN. I think he is, too.

I wonder when it would be practicably possible for us to get that? Would it be a week, a month, two months? I am convinced we have to act quickly.

Mr. GOLDIN. Mr. Chairman, I am going to call the Governor and mayor when I return to the city, explain the urgency of getting that information, and I am sure every effort will be spent getting it.

The CHAIRMAN. We are going to mark this bill up tomorrow. Can you have it for us tomorrow?

Mr. GOLDIN. We can try. I will say, Mr. Chairman, the parameter we are talking about, based on our best information, is that the number is not of a magnitude that some members of the committee may think. I tried to indicate earlier, based on our efforts in the last few days to put together some estimate we appear to be talking about something in the neighborhood of perhaps \$275 million in all of the accounts of all of these agencies, including amounts dedicated to debt service.

I would like to say, Mr. Chairman, when the session is over tonight, tomorrow, I will be available to meet with any member of the committee who has further questions and who would like to go through any of the numbers. We have got extensive computer runs, cash flow projections, and any other information we can provide that there hasn't been an opportunity to elicit today.

The CHAIRMAN. Mr. Levitt, would you say this table was accurate?

Mr. LEVITT. My staff informs me it is accurate.

The CHAIRMAN. Senator Morgan hasn't had a chance to ask any questions at all.

Senator MORGAN. Mr. Chairman, I apologize for leaving, but I had another committee meeting.

Is it true, Mr. Levitt, that the law of the State of New York requires each municipality to have a balanced budget?

Mr. LEVITT. It requires the State to have a balanced budget, and I think by virtue of long practice each municipality is required to have a balanced budget.

Senator MORGAN. I thought I heard Mayor Beame say on a national TV last weekend that that was true.

You mentioned in your opening statement that you had supervision or oversight of the municipalities of New York.

Mr. LEVITT. Yes.

Senator MORGAN. Is it part of your responsibility to oversee the financial affairs of the city of New York?

Mr. LEVITT. Since 1971.

Senator MORGAN. I assume that the bookkeeping system that we have heard described so many times is one of the reasons you failed to discover this situation?

Mr. LEVITT. We discovered a great many inadequacies and we reported on them in audits, and I can furnish you with copies of the audits.

Senator MORGAN. When did you begin to report them?

Mr. LEVITT. Right away; as soon as we got the statutory mandate to do it.

Senator MORGAN. That is back in 1971?

Mr. LEVITT. Yes, sir.

Senator MORGAN. Were any efforts made to correct the financial affairs?

Mr. LEVITT. Some were made and some persisted.

Senator MORGAN. The thing that concerns me is that if the Federal Government should decide to guarantee the securities of the city of New York, inevitably there will have to be a reckoning day if you decide to continue on, as you have in the past.

From what I have heard from this testimony today and in other days your tax rate is—what is it?—an 8-percent sales tax in the city of New York, 7 percent in the State, and I don't see how you can increase taxes any more in your State and not have a bad effect.

I wonder whether or not those who hold contracts with the city will be willing to renegotiate those contracts. Do you think if you are able to prevent the city from defaulting that those who hold what I call exorbitant contracts would still be willing to negotiate?

Mr. LEVITT. I think Mr. Goldin can answer that. But my own opinion is yes, they will be able to renegotiate contracts provided there is no default. But one of the horrible consequences of default, of course, would be the inability to even buy necessary goods.

Senator MORGAN. One of the things that gives me a great deal of difficulty is that I would say that the average policeman on the beat in New York City makes more than 95 percent of the criminal justice personnel in North Carolina. Your college professors are much, much higher paid in New York than in North Carolina, and, of course, we may not be paying ourselves as well, but we have a surplus at present.

For years I have avoided New York. When my wife and I fly to Bermuda, as we do quite often, we always make it a point to come through Dulles Airport because of the tax rate, the exorbitant hotel bills. I had to spend two nights in New York, at the U.N. this year, and

my hotel bill for a single was something like \$65 a night, \$1.50 for a hot dog at the airport. I think you have reached the point of diminishing returns.

Mr. LEVITT. I think New York has simply been a victim of inflation.

Senator MORGAN. I understand the problem you gentlemen are confronted with; I sympathize with you. I just don't want the Federal Government involved in a situation that we can never get out of, that will never be alleviated.

That is the thing that worries me.

Mr. RIFKIND. I hope the Senator is taking account of the fact that the city is being managed by an entirely different system of government now.

Senator MORGAN. My understanding is the Senators have finished questioning the panel, except for Senator Stevenson.

Senator STEVENSON. Mr. Chairman, I will try to be brief—

Senator WILLIAMS. We have five additional witnesses, but this is very important, so proceed at whatever length you would like to.

Senator STEVENSON. Mr. Goldin, getting back to where we left off—the cash flow for the city, between now and the end of June—what would the borrowing requirements of the city be, including debt service?

I have a figure of \$3.9 billion. Is that right?

Mr. GOLDIN. The total borrowing requirements between now and the end of the fiscal year would be \$4.9 billion, but the anticipation is between now and the end of November, based on the page referred to earlier, \$1 billion will be financed by MAC, and therefore from December 1 until June 30, the borrowing requirements would be \$3.9 billion.

Senator STEVENSON. Now, it has been suggested repeatedly that default would be followed by horrendous consequences, but that is without consideration of the possibilities of reorganization which might accompany default.

And such reorganization could include a guarantee to help cover any operating deficit during the period of time that the city would not have access to the capital markets.

During the first 4 months you indicated that the operating deficit, exclusive of debt service, would be about \$1.2 billion.

Assume, if you will, that during this period, the city is going through the normal process of reorganization for insolvent municipalities and corporations, and that as a result its debt is reorganized, the principal payments deferred, so that it or the trustees could issue certificates which would have a priority over any existing debt.

Of that \$1.2 billion, how much could be banked on such terms?

Mr. GOLDIN. Senator, I would assume in the aftermath of a default, in the face of the cash flow figures that would establish, we would have, if we paid no debt service, an opening cash shortfall for all services in December of \$389 million, in January of \$329 million, in February of \$122 million, and in March of \$380 million, that it would be exceedingly difficult in the absence of a Federal guarantee, to be able to sell any kind of an instrument.

We would be bankrupt, in default. And we would have a cash opening shortfall that would be massive, without paying any debt.

Senator STEVENSON. I have some indications in this case that as much as \$800 million of the \$1.2 billion could be financed without

a guarantee, and of course, the rest would be financed with a guarantee.

Mr. GOLDIN. May I respond to that?

Obviously, whatever information is available to the Senator, he will have to evaluate, and the committee will have to evaluate. I would think most experts would consider it extraordinary that that kind of a quantum could be marketed in the public or private markets in the aftermath of a default.

Indeed, it may interest the Senator to know in connection with the strenuous efforts I have made as comptroller to analyze and evaluate the situation on an ongoing basis, I have tried to determine when, if the city in this climate were to seek right now to create a new instrument, an instrument that would be secured with a loan to an independent trustee, on class categories of revenues that could be certified by an independent accounting firm, never brought to the city, for relatively short periods of time, we would have much success.

And I have been advised by some of the leading municipal bankers in the country that it is illusory for me to think the city has that possibility in this environment in absence of default.

Senator STEVENSON. That is one reason we are suggesting a different environment. There are other possibilities.

Mr. GOLDIN. Except the potential universe of lenders, who legally, if nothing else, have the option of advancing credit prior to a default would be substantially narrower in the aftermath of a default.

Senator STEVENSON. The total debt of the city now exceeds \$14 billion, and the deficit for the balance of this fiscal year including MAC obligations is about \$4.9 billion. Even in the circumstances and climate which I mentioned, namely, reorganization, consolidation, and postponement of debt will a priority for trustee certificates, you can't finance the short-term deficit. How are you going to finance the deficit with \$6 billion?

The concern of many is that we are just postponing the day of reckoning. That goes back to the concern expressed by many about the consequences of a default in the bond market.

Many sophisticated investors feel the worst thing the Federal Government could do, a grievous form of fiscal responsibility at a time when public confidence in the fiscal responsibility of the Government is already low, would be to come in with a \$5 billion guarantee and to that extent, a contingent liability added to all of the others of the Federal Government, with no assurance that it will do anything except postpone the day of reckoning.

I have some charts prepared by the staff which are probably based on information furnished by your office or perhaps the State, which indicate that even with the \$6 billion, the unguaranteed debt would have to go up to \$10 billion by 1981.

How could we possibly get there, on the basis of what you have just said?

Mr. GOLDIN. Senator, let me try to deal with each of the points and then get to the ultimate point.

You will note that under legislation, indeed there has been substantial beginning compliance with the requirements of the legislation, a plan that was enacted Monday of this week for the \$200 million in cuts, under the legislation providing that virtually, in 21

months, on July 1, 1977, the city has to be operating under a balanced budget, there is a reasonable period of time—

Senator STEVENSON. The law always required a balanced budget.

Mr. GOLDIN. No, sir. If you permit me, the laws have required a balanced budget without depicting what a balanced budget means.

Now the law not only provides for a balanced budget, the law says what a balanced budget is.

The law says unlike formerly, when a balanced budget could legally comprehend accruing revenues and be on a cash base for payables which allowed you to create operating deficits on a current basis, that that is no longer permitted, because now standards of accounting and budgeting are spelled out in the law, so the law now defines what a balanced budget is.

And under that definition, we are legally required to have the balanced budget by July 1, 1977.

Senator STEVENSON. How do you have a balanced budget, and also increase your debt at the same time?

I see it going up in the aggregate, guaranteed and unguaranteed.

Mr. GOLDIN. Senator, that includes capital requirements. We have ongoing capital requirements for the renewal of plant. The expectation is that there will be a substantial increment reduction, pursuant to the plan that was enacted Monday night, looking forward in our capital budget.

We do, though, have the requirements to repair leaky roofs on schools and try to keep the East Side Highway from collapsing, essential maintenance of the capital plant.

So we look down the road to the increment of debt only for two purposes.

One, in order to be able to finance limited essential capital purposes; and two, to be able to even out financial imbalances.

Our peak is reached next year.

Senator STEVENSON. That makes the point. It is balanced except that capital expenditures, quite understandably, are not.

Mr. GOLDIN. Senator, we are talking now about an important theory with which you are familiar with public finance.

Historically, in the United States it has been felt that expenditures that are nonrecurring in nature, expenditures that will benefit more than one generation of taxpayers, ought not to be paid for fully by a single year of taxpayers, that they ought to be paid for over the lifetime of useful necessity by all of the taxpayers who will enjoy them.

The city, under the new system, will now be restricted to the orthodoxy of capital financing. We will be able to finance projects only to the extent that they have a period of probable usefulness looking out into the future and the period of paying them off will relate to the period in which future years of taxpayers will enjoy them.

We will no longer understand this law, which carefully restricts our ability to borrow now for the first time, not only defines it, but limits it in a dollar amount, be able to borrow to finance operating deficits which we are no longer able to create.

Senator STEVENSON. I don't want to prolong this, Mr. Chairman.

The point is fairly obvious. Simply as a result of orderly reorganization of the finances of this insolvent municipality, its borrowing

requirements for the short term could be reduced and the exposure of the Federal Government could be substantially reduced, with far less anxiety in the national community and the money markets. This would be the result of a conventional, routine, businesslike approach to a situation which is not uncommon except for its magnitude and the degree of mismanagement.

Mr. GOLDIN. The critical variable, if you permit me, Senator, is that—maybe it is in large part a function of quantity or size—that in the case of another entity, a smaller entity, which defaults, in the aftermath of reorganization, credit, because of the conventionally small sizes that are necessary, can continue to be available.

Based on the magnitude of our borrowings, even if restricted for capital purposes, for financial borrowings, for receivables, it is difficult to imagine that in the aftermath of a default, given the legal limitations that would adhere, and would limit the potential universe of investors, that credit in the prudent and careful size we would require, it could conceivably be available.

Senator STEVENSON. I am certainly concerned, as you are, about the consequences. I am concerned about it either way. But we will have an opportunity to ask experts out in the market about the consequences of the two approaches.

Mr. GOLDIN. Senator, would you permit me to add a further point. I want the Senator to have it in mind. I would like to point out that there was a further disastrous consequence of default for the city itself, again regardless of the ripple effects. I pointed out that all of the projections of revenue action, Senator, next year and in future years, that are predicated on the city's ability to tax real estate revenues as a consequence of serving existing outstanding debt would have to be drastically revised.

The availability, for example, of real estate tax revenue next year, if we were to default, could be reduced under the constitution by as much as \$1.4 billion. So we are talking, on the one hand, about a massive operating cash shortfall, if the paid no debt service, and on the other hand, about the reduction that is equally massive in the available revenues to the city because constitutionally we would no longer be eligible to levy and collect \$1.4 billion in real estate taxes because of our default.

Senator STEVENSON. I understand that tax, but there is some question about its constitutionality?

Mr. GOLDIN. Again, if you permit me to offer this, the New York State Constitution respecting the taxation of real estate price, that real estate can be taxed up to 2½ percent of its average full valuation over a 5-year period for operating purposes. It provides that above that, real estate can be taxed solely for one purpose, to service long-term debt.

Senator STEVENSON. We are aware of that, and I understand your explanation. Mr. Levitt?

Mr. LEVITT. I was merely going to suggest I hope, I earnestly hope the Senator will not overlook the importance and significance and the effectiveness of the emergency financial control board of which I am one member.

This is indeed a body that imposes a trusteeship on the city of New York. As a matter of fact, when I saw the design of that body, it seemed to me that per se this would reopen the credit markets in the

city, the very existence and implementation of that device. It hasn't but I assure you that this is a potent and powerful influence and if such legislation as you see fit to support imposes a Federal presence on that board, that I think might also be desirable.

Mr. RIFKIND. May I add a theological note? We have talked about default as if it was purely a fiscal decision. I happen to regard default as a dishonorable decision. I don't think it is the people of the city of New York who are the impoverished; it is the city that is impoverished, not its citizens; I don't think they ought to be subjected to the dishonor of a default. I don't believe there is a business institution in this country, who, faced with the problem we have, in proportion, would not rather seek the kind of relief from someplace that we are talking about, rather than the bath of default that Senator Stevenson is talking about.

Senator STEVENSON. Judge, I have to respond to that. If there is any dishonor, it doesn't belong to the people of New York, it belongs to those who put the people in this position. And I don't want to reward them for the dishonor which they have heaped on the city of New York. That is one of the consequences of this \$5 billion proposal, a reward for some of those noble people to whom we referred earlier. The comptroller said they were not guilty of criminal behavior, and he may be right, but they are guilty of some other behavior, which I think our members have indicated is not, at the very least, up to the standards to which we have fortunately been accustomed in this profession, at least in my State. I don't see anything dishonorable at all about a policy of the Federal Government, which in this case, as in other cases, reorganizes the debt of the city of New York in a way that benefits the people, relieves them of the obligations of paying off that debt, without rewarding those who have dishonored the city.

Mr. RIFKIND. Talking about reward, Senator—

Senator STEVENSON. It makes me think, Mr. Chairman, that maybe the way out of this is to loan New York City Mayor Daley.

Mr. RIFKIND. I was going to remark, Senator, that somebody suggested New York was like a heroin-addicted girl, I don't think you reward the girl if you endorse her note for a hospital program to get relief from her addiction.

Senator STEVENSON. I am all for a cure.

The CHAIRMAN. Well, gentlemen, thank you very much. This has been a remarkably helpful and useful panel. You have impressed me deeply with your knowledge and information.

Mr. GOLDIN. Mr. Chairman, I do have some material here that may be helpful to Senator Stevenson. These are the page proofs from the printer of the comptroller's annual report for the fiscal year just ended. It has fund balances definitively for the city, for many covered organizations through June 30. We will undertake to use everybody's best efforts to get them for you all of the covered organizations on an undated basis.

Senator STEVENSON. Thank you.

The CHAIRMAN. Our next witnesses are Ira Millstein, Weil, Gotshal & Manges; Michael Cook, Semeon Gold, and Mr. Lewis.

Gentlemen, I think you understand the problems we have. We have a panel following you, which we are very anxious to hear, and it is very late in the day. We hope you can be concise as possible.

**STATEMENT OF IRA MILLSTEIN OF WEIL, GOTSHAL & MANGES;  
ACCOMPANIED BY MICHAEL COOK, SIMEON GOLD, AND MR.  
LEWIS**

Mr. MILLSTEIN. Senator, we have no prepared statements. We have really come to provide whatever assistance we can to the committee.

I would like to briefly touch on three points discussed earlier.

My law firm was retained about 4 or 5 weeks ago for the purpose of consulting the city on matters relating to the default.

As a result, we have been researching pretty hard a lot of questions connected with the default, and we have evolved one of the specialties in the world, that is advising people how to default, which is a unique field.

We have done a good deal of research and we would be prepared to respond to any questions you have.

There were two or three things raised today that I think might be helpful.

The CHAIRMAN. Question one we would like enlightenment on is if you could inform the committee, in the event of a default, how does that affect the revenues of the city of New York?

As I understand it, some of the proposed tax revenues might or might not disappear.

Can you give us advice on that?

Mr. MILLSTEIN. Unless the Federal statute is amended—and I want to direct my remarks particularly to Senator Stevenson—under the State law as it presently exists, there is one mechanism for defaulting, filing a petition of default in the State of New York.

That is under the same legislation that created the emergency control board.

Paragraph 85 of that law provides for a stay of all claims against the city.

Under the current law as it exists, we have a serious problem, because this law, as it exists, provides in the event of default, and during the period of the stay, the municipality may spend moneys to maintain and provide such service and for such purposes as are determined to be necessary by its emergency financial control board.

The question we faced last Thursday night when default seemed imminent was, Did that provision come before the provision in an earlier part of the statute which said that the bonds had to be paid first, no matter what? And did that provision in particular override the provisions of the State constitution which do deal with the revenues raised out of real estate taxes?

Had we been forced into court, we would have taken the position that they do.

However, I must be completely candid in stating there would be one whale of a litigation about this, because the bondholders clearly would have showed up on Friday afternoon contending that this provision was unconstitutional, and that no matter what the State law provided, the State constitution overrode the State law and we would be litigating for years under this statute as to whether or not the bonds went first or the various city services went first.

The position of the city, and my instructions in court were to be that essential services would be first and we were to fight for those essential services and the provision of money for those services.

But, as you heard Mr. Goldin state, in his construction of the constitution, he was nevertheless mandated to take those revenues and put them to the bondholders until ordered to the contrary.

As I stated, we would have had a massive litigation.

Under State law it is totally unclear. This statute has never been tested and I can't predict what would have happened, other than extensive litigation and great confusion and uncertainty.

The CHAIRMAN. What does that mean, extensive litigation, confusion, and uncertainty?

You can't predict what would happen, but can you give us any picture of the likely action that would be taken?

We were told by Mr. Goldin that there is a priority system of meeting essential services, that life support services would be met.

Are you satisfied that the bankruptcy statute as it now applies would permit that?

Mr. MILLSTEIN. No. I believe the State statute is not clear. It is contradictory and it is questioned as to its constitutionality.

While I would have defended it to the end in order to have life service provided, I have no certainty that would have been the result in court.

That is where the problem with the State statute exists.

I do believe a State supreme court justice would have certainly leaned in the direction of providing life services before the bondholders were paid.

However, courts must act under law, and with all of the feelings he might have, the emotional bent he might have to provide the city services first and the bondholders last, still this is a State law and State constitution and it has to be dealt with and the issue is far from resolved.

I would point out we would fully anticipate a massive litigation the very date we were about to file the petition.

The CHAIRMAN. Perhaps I didn't make the question clear or perhaps I missed your answer.

But there was the point made in the event of default the city would in fact lose certain property tax revenue, hundreds of millions of dollars.

Mr. MILLSTEIN. That was the comptroller's opinion.

Under State law, I think we would have been going to the Supreme Court of the United States.

Again, it is unclear. We would have taken the position that under State law those revenues had to go to provide essential services.

The CHAIRMAN. What are those revenues; how much?

Mr. MILLSTEIN. I don't know. We are not here as fiscal experts. We were simply preempting priorities, and attempting to make sure whatever moneys came in went to essential services.

I would like to point out the problem that is one that exists with State law.

I would like to get to Federal law for a minute, because Senator Stevenson mentioned the fact there is an existing chapter 9.

Under Federal law if we could find a way to get into court, I think the priorities would definitely change because there we have a constitutional provision which gives priority to the Federal bankruptcy

statutes, and that is a constitutional provision and the Federal bankruptcy statutes could override the State constitution, State law—

Senator JAVITS. You don't mean override. You mean preempt.

Mr. MILLSTEIN. Preempt.

However, the existing chapter 9 is utterly inadequate, and I don't think there could be any use of the existing chapter 9 at all.

You would need a thorough overhaul of chapter 9.

The Commission on Bankruptcy Laws of the United States, in July 1973, reported there had been 350-odd cases—I am quoting chapter 9—involving in the neighborhood of a total of \$207 million of admitted debt.

Now, it is perfectly clear when we are talking about New York, with billions and billions of dollars of debt, that chapter 9 as drafted was really intended to handle sewer districts and the like and not a municipality of 7 million people.

It is utterly inadequate to deal with the problem for a whole variety of reasons.

As it stands now, New York couldn't even get into Federal court under chapter 9 because it requires 51 percent of the creditors to agree—we don't know who the creditors are. They are all bearer creditors. And we couldn't begin to locate them.

It requires you come in with a plan, and we can't do that, either.

So you would need a total overhaul of the existing chapter 9.

The CHAIRMAN. The point has been made once you go into default the creditors would identify themselves emphatically and quickly.

Mr. MILLSTEIN. Senator Proxmire, you can't get into default unless you know who 51 percent of them are.

There is a jurisdictional hurdle to overcome under that chapter. You must state you have agreement of 51 percent of the creditors to get into the door of the courthouse. You have to identify them first.

If the Federal judge would look the other way and let us in the door and identify the creditors later, maybe. But I must tell you, Senator, that that is not the way the statute reads. We have a jurisdictional hurdle to jump to get into court, and we can't jump it. We can't find 51 percent of the creditors until we get into court. And we can't get into court until we know the 51 percent.

So what I would like to suggest is that it would not take a few simple amendments of chapter 9, you would need a total overhaul. And I made a list while I was in the back of the room of the kind of things you would need. You would need a provision for a certificate of indebtedness. There is no provision for one now.

Senator STEVENSON. Mr. Chairman, this assumes the 51 percent and two-thirds requirement would have to be deleted. Could you furnish the committee with a list of the additional changes that would be required?

Mr. MILLSTEIN. We certainly could. We have been for the last several weeks preparing a draft of an amendment and it is prepared and ready to go.

Senator STEVENSON. Could we have a copy of that?

Mr. MILLSTEIN. Surely. We would be pleased to do that.

The CHAIRMAN. What committee were you working with in preparing those amendments?

Mr. MILLSTEIN. We have been working with the staff of the House Judiciary Committee.

The CHAIRMAN. Is there any indication of how promptly that kind of relief would move through the House?

Mr. MILLSTEIN. It hasn't moved anywhere. It is still in the draft stage at the staff level.

The CHAIRMAN. Would hearings have been scheduled?

Mr. MILLSTEIN. Yes; there have been 2 days of hearings on amendments of chapter 9 in the subcommittee.

The CHAIRMAN. Have they completed the hearings?

Mr. MILLSTEIN. I believe they have, although I can't speak for the subcommittee, I believe they have. However, nothing has come out of the subcommittee other than a lot of hard work by us and the staff, and they have been cooperative and thoughtful and a lot of work has gone into it.

The CHAIRMAN. Has there been any action in the House Judiciary Committee?

Mr. MILLSTEIN. No. There has been no action in the Judiciary Committee and no action at the subcommittee level, other than at the staff level. That is all.

The CHAIRMAN. Senator McIntyre.

Senator McINTYRE. Thank you, Mr. Chairman.

In testimony last Saturday, Mr. Millstein, you really persuaded me to take the position I have taken so far, when you said:

Senator McIntyre, there is one aspect of this—I'm not going to talk to the rippling effect on bonds or the security markets, but having watched and participated as the entire city administration stayed up for 48 hours as a city facing default situation, the total uncertainty involved when a city of the size of New York faces default, not in terms of world markets or not in terms of what's going to happen to bonds next year, but what's going to happen the day of default. Nobody has ever defaulted before in this dimension of this size. This is not a big business going into default or a small business going into default. This is the City of New York going into default and there are a host of relationships which have existed between creditors and debtors and sellers and vendors to the city that have just existed for dozens and dozens of years because they exist.

Now when you go into default all of those relationships become open to question for the first time. Bank accounts can be attached. Setoffs can be claimed. Money that the city thought that it had ready to pay checks with might be grabbed by attachment or otherwise by somebody else. Welfare checks begin bouncing.

With all the planning in the world and with all the foresight in the world, since there's no form book to go to see what happens when a municipality the size of New York defaults, there isn't anybody who can tell you what happens the next day on the streets. Will the garbage men stay in the trucks—I don't know—if those checks are stopped? There were rumors yesterday that possibly they might not. Will the banks honor bank accounts or setoffs? I don't know. Nobody knows exactly what's going to happen until they are faced with that possibility. Will litigation begin as between various holders of securities contesting each other as to who has priority? Nobody knows because this never happened before.

I could give you quite a list of the uncertainties that we face and how we tried to cope with them, but I don't think there's anybody in the United States who can tell you what it was going to be like the next day. We could only guess and there wasn't any way to know.

That is a form of uncertainty in my judgment which transcends the uncertainty about the bond market or anything else because that was an uncertainty about the citizens of New York and what was going to happen to them in the ensuing days, and there isn't anybody who can give you a clear answer to that one. Only hopes and speculations and a lot of attempts, but no clear answer as to what was going to happen the next day.

But anyway this magnitude thing, I think you said, even the courts were not set up to handle this. So here we are talking about who is

wrong, how many guys had telephones in their vehicles, and we have got a real tough question we ought to face up to and move in and give help.

Mr. MILLSTEIN. Senator, I have nothing to add to what you said.

Senator McINTYRE. I am sorry to steal your thunder, but that answer to my question turned me around.

Mr. MILLSTEIN. Senator, that is exactly what we confronted last Friday, and we were there.

The CHAIRMAN. Senator Stevenson.

Senator STEVENSON. First of all, no matter what happens, there is going to be some uncertainty here, there is going to be a lot of uncertainty if Congress doesn't act on some alternative here.

There is no evidence so far the Congress would even approve it, let alone the President sign this proposal into law. So we are up against a tough practical question.

Even if it the \$5 billion guarantee becomes law, according to many so-called financial experts, it would be accompanied by a great deal of financial uncertainty. You might be postponing the problems, but not eliminating them.

The trouble with the question that was asked that it sort of assumed a default without more—some of the uncertainty that follows from a default could be reduced, couldn't it, if instead of this \$5 billion proposal, the Federal Government were to create an emergency loan board that did have some authority to, either through guarantees or other devices, make financing available to the city so that at least as far as the continuing operating expenses of the city were concerned, they would be paid.

The uncertainty would be about the status of the bondholders. During this process, which could be lengthy, hopefully and perhaps with some changes in the bankruptcy law the city's finances could be reorganized.

Mr. MILLSTEIN. Senator, I think the answer I gave to Senator McIntyre applies again.

I think that we mustn't try to oversimplify a default. Bear in mind I am not an advocate for a position; we are simply lawyers and I am trying to explore with you what happens in the events of a default.

We spent many weeks thinking about it. It is rather frightening. Here are a few examples. It is not simply a question of saying, all right, everybody is frozen where you are and you must wait a couple of years and we will get around to you later, and in the meantime we have a few dollars to take care of immediate needs.

What about all of the investors and the people who rendered service to the city in the years preceding default? The city is not up to date in its payment. Many of them are now at this moment unpaid for lengthy periods of time.

And my understanding is that represents millions, if not billions of dollars. In addition, we have bondholders, note holders, and so on down the line.

I didn't invent any of these things; that is the current state today.

In addition, the real question is going to be what is the relationship of all of these creditors, who goes first as among them. When we say "postpone," who gets postponed, how long do they get postponed.

When the postponement stops, who gets paid first, and in what order, and how much?

Again, what about the so-called onerous contracts and burdensome contracts the city has? Is anybody, like a Federal judge or the city of New York, going to go in and set aside the validity of union contracts, pension agreements, purchase arrangements that stretch out years ahead, capital requirements that stretch out years ahead.

I think there are lots of people who are going to come in and say, before you tell me I ought to be postponed, the teachers ought to take a cut and that contract ought to be eliminated; before you tell me I have to wait, that contract to public MTA transportation is an onerous and burdensome one. Get rid of it.

I could sit here and go on for about an hour of all of the problems that would come up that some judge is going to have to unravel simply to deal with the question of who gets delayed and how long.

Senator STEVENSON. I agree; I understand that.

But you raised the specter of vendors not getting paid——

Mr. MILLSTEIN. They are not.

Senator STEVENSON. They are not getting paid. I am a very rusty lawyer at the moment, but I do say this with the advice of some lawyers who are not so rusty—though I have no doubt you have done far more work on this than anybody—that there is no quarrel with 99 percent of what you are saying about the long-term problems and the priority of the creditors.

But if coupled with emergency assistance from the Federal Government, whether it is through Federal Reserve Board financing, or accelerated payments, or a loan guarantee or some combination, that your vendor-type situation, your ongoing day-to-day operations, all of your current accounts, are going to be better off. There will be less uncertainty.

Mr. MILLSTEIN. The people who are selling the city today, or tomorrow after the default will be better. But the people who sold the city in the years preceding the default will not be better, because they will be taken as a package and put over here and left to do—what with, I don't know.

But you see, the problem, I think, that you are tending to minimize is the work out. How in the world does the city get out of this default, this insolvency?

Because in order to get out, you have to reach some agreement among these literally hundreds of thousands of creditors.

Nobody ever had to deal with that many creditors.

I suggest, Senator, what would happen in the default is that it would take years, literally, no matter even if we balanced the budget 3 years hence, as the law requires, it would still take years to work out of that event of default, because of the litigation as to who was going to get what when the default was lifted, and I don't see the end of it.

Senator STEVENSON. I agree.

The alternative is an endless—it could be an endless process.

Mr. MILLSTEIN. I am all for discipline—having been born and brought up in New York, I think a little discipline would be splendid—but I think default—you must get any bankruptcy people and litigators that have been in court, talk to them and think about the events of default.

It is unmanageable; it will involve litigation; it will put New York in the position of not going back to the markets for I don't know how long, because I don't think you should think because the city balances its budget the third year from now, it is ripe and ready to go back into the markets if its counsel are still litigating with the existant bondholders and creditors existing in 1975 as to who gets what and who has to wait longer than which, and why they don't all get paid at a certain time.

Will we ever get agreement; will the court accept a crackdown provision; I don't know. I have no way of telling you what or when we will come out of that event of default.

I urge you to talk to anybody and see if they can invent a better system. Please tell them to see us, I would really like to know how to do it better. We don't have a very good solution.

Senator STEVENSON. This is not a good system. The question is whether others aren't worse.

Mr. MILLSTEIN. I can only point to the one I know about. I am not a financial expert. I can't talk about ripples; I just want to talk about the thing we have been studying, and that is the question of default, the event of default, what it means.

Sure, we will be busy for years in courts, and so will many other lawyers, and maybe that will end the recession, but it seems to me that is not a fruitful thing to do—as Mr. Axelson said, the huge divergence of city management into working with us and fighting with the creditors.

I was there for a short period of time and watched what happened, the whole city was working, the mayor—all of a sudden we were the most important people in New York, because we had to tell them what was going to happen the next day.

We had the whole city administration sitting there; nobody was doing a thing except sitting there and wondering could we really get some priority, what was the judge going to say when we walked in.

Those questions are not going to go away, Senator. They are still there, and we will be making tremendous demands on the city administration for their time.

I think it is a terrible diversion.

Does anybody have any questions on a default?

Senator BIDEN. Did you say on default or in default?

I have no questions.

Mr. MILLSTEIN. John Lewis is the head of our trust department, and you heard discussion before about what happens to the city's financial paper in the event of a default, even after we come out of a default.

Last night we hurriedly pulled together the research we have been doing to show you in at least 27 States what happens once New York City defaults.

Mr. Rifkind mentioned it, the comptroller mentioned it. I would like to submit to you seven copies of a memorandum—it is all I brought with me—which outlines the various things that happen in various States once a default occurs.

The problem is not only a question of fiduciaries. There are commercial banks which would not be permitted to touch our paper for 5 or 10 years in some States; savings banks will not be able to touch our paper for 5 or 10 years once there is a default—

The CHAIRMAN. Without objection, that will be printed in the record.

[Document follows:]

OCTOBER 23, 1975.

CONSEQUENCES OF NEW YORK CITY DEFAULT UNDER STATE LEGAL INVESTMENT LAWS

This memorandum sets forth in tabular form those categories of individuals and institutions which might be precluded, under the legal investment laws of the various states, from purchasing securities issued by a municipality that has previously defaulted on its indebtedness. The following should be noted in reviewing this memorandum:

1. The legal investment laws relate to permissible investments by such persons and institutions as trustees, executors, administrators, guardians, banks and insurance companies. The information set forth in this memorandum with respect to the state legal investment laws governing trustees, executors, administrators, guardians, trust companies and savings banks has generally been obtained from Volume 4 of the Prentice-Hall Estate Planning Reporter. The P-H Reporter does not cover investments by insurance companies or, with the limited exceptions noted in the table below, investments by banks other than savings banks and trust companies. Further research is presently being conducted into the restrictions governing investments by such institutions. However, preliminary examination of the insurance laws of several major jurisdictions, as set forth in the CCH Blue Sky Law Reporter, indicates that similar investment restrictions may be applicable to insurance companies in certain states. (See table below.)

2. Some states do not allow purchase of bonds issued by out-of-state cities under any circumstances (e.g.—Utah). Hence, default has no impact.

3. Some states permit certain of the categories of fiduciaries to purchase securities which are eligible for purchase by certain entities organized under federal law. For example, Texas allows trust companies to purchase any investment which a national bank could purchase. The regulations of the Comptroller of the Currency permit unlimited investments by national banks in municipal securities, subject only to the Prudent Man Rule described in note 5 below.

4. Those states in which default on a city bond has some impact are listed below. These default restrictions generally do not apply to all categories of persons covered by the legal investment laws of the relevant state (e.g., savings banks but not trustees might be precluded from purchasing bonds from a city which has previously defaulted). The affected category or categories are noted in the table. This memorandum has not attempted to include the highly specific default provisions of certain states which are applicable only to certain agencies or instrumentalities of a city (e.g., highway authority bonds).

5. In certain states not included in the table because there is no explicit provision limiting investment in the event of a default, there may be other legal investment provisions which indirectly have the effect of eliminating securities of an issuer which has defaulted from the fiduciary, bank and insurance company investment markets. For example, certain states have credit rating and/or net worth requirements applicable to municipal securities. In addition, the Prudent Man Rule which is applied in many states may preclude investment in municipal securities that are deemed to be unduly risky. A common version of the Prudent Man Rule requires a fiduciary to "exercise the judgment and care under the circumstances then prevailing, which men of ordinary prudence, discretion and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income therefrom as well as the probable safety of their capital.

<i>State and affected category</i>	<i>Restriction</i>
Arizona: Insurance companies-----	Investment precluded if security is then in default in any respect; investment precluded if there has been default on any other security within 5 years prior to investment.
Arkansas: Guardians (ward)-----	Investment precluded in an issue of securities which has been in default for period exceeding 120 days in 5 years preceding investment.

<i>State and affected category</i>	<i>Restriction</i>
Arkansas: Insurance companies...	Investment precluded if security is then in default in any respect; investment precluded if default in principal or interest on obligations to be purchased within 5 years prior to investment; or if issued less than 5 years prior to interest, no default on principal or interest on any issuer obligations within 5 years prior to investment.
California:	
Commercial banks and savings banks (for their own account).	Investment precluded in bonds or other evidences of indebtedness if default on any part of principal or interest on any debt for a period of more than 90 days in 10 years prior to investment.
Insurance companies-----	Investment precluded if security is then in default as to principal or interest; or if obligator has defaulted on any part of principal or interest on any legally authorized obligation issued by it for more than 90 days within 2 years prior to investment.
Colorado: Guardians of minors and incompetent beneficiaries of VA benefits.	Investment in bonds or other securities permitted if issuer not in default with respect to principal of any of its general obligation indebtedness at any time within preceding 10 years.
District of Columbia: Trustees, ex-ecutors and administrators.	Investment in bonds obligations precluded if default in the payment of any part of principal or interest on any of lawful obligations for more than 120 consecutive days at any time within 20 years preceding the investment.
Florida:	
Guardian holding funds received from VA.	Investment precluded if default on any part of interest on bonded indebtedness for more than 90 days within 15 years prior to investment.
Bank or trust company-----	Bonds and securities invested in must be current as to all payments of principal and interest.
Insurance company-----	Investment precluded if security is then in default in any respect.
Georgia: Banks-----	No restrictions in Prentice-Hall but the Department of Banking and Finance is authorized by statute to promulgate regulations.
Hawaii: Trust companies and savings banks.	Bonds investment precluded if any default in payment of principal or interest of any general obligation within 5 years preceding investment.
Idaho:	
Corporation doing trust business.	OK if bonds are acceptable by U.S. Government as security for deposits of postal savings bonds.
Savings banks-----	Investment precluded if default in interest on legal funded debt in three years preceding the investment.
Illinois:	
Guardians-----	Investment precluded if default in a payment of principal or interest on bonded indebtedness during 5 years prior to investment.
Insurance company-----	Investment precluded if municipality is then in default on payment of principal or interest on any of its direct, general obligations.

<i>State and affected category</i>	<i>Restriction</i>
Iowa : Savings banks-----	Bond investment precluded if such bond or security shall have been in default as to principal or interest for 5 years preceding investment. (Superintendent has further power to define permissible investment characteristics of bonds).
Kansas : Savings banks-----	No bank permitted to invest in excess of 15 percent capital and surplus in bonds if any bond, security or evidence of indebtedness has been in default of payment of principal or interest within 10 years prior to investment.
Massachusetts : Savings banks----	Bond investment precluded if default in payment of any part of principal or interest on bonds, notes or other interest bearing obligations for a period of 120 days within 10 years preceding investment.
Michigan : Insurance companies--	Investment precluded if failure to pay principal or interest of debt for a period of more than 6 months within 3 preceding years; investment in bonds or other evidences of indebtedness permitted if by statutory or other legal requirements, such obligations are payable, as to both principal and interest, from adequate special revenues pledged or otherwise appropriated or by law required to be provided for the purpose of such payment.
Missouri : Banks and trust companies.	Banks and trust companies in cities with population of 100,000 or over precluded from purchasing bonds in excess of 15 percent of capital and surplus accounts if any default in payment of principal or interest on general obligation bonds or other evidences of debt for period of more than 120 days in 10 years preceding investment.
Nebraska :	
Trust companies-----	Unclear whether there is authorization to purchase New York City bonds; if there is, precluded from purchasing bonds the interest on which has been in default for a period of 2 years preceding purchase date.
Insurance companies-----	Investment precluded if municipality has defaulted in payment of any principal or interest on its bonds, securities or other evidences of indebtedness within a period of 2 years preceding investment; except that investment permitted in a refunding issue of any such bonds where security for the indebtedness refunded has been increased or the principal or interest rate reduced or maturities extended, if there has been no default in principal or interest of the refunding bonds.
New Jersey :	
Fiduciaries -----	Investment precluded if default in payment of any principal or interest on any stocks, bonds, interest bearing notes or obligations within 120 days preceding investment.
Savings banks-----	Cannot invest in bonds of New Jersey or non-New Jersey City if such city has defaulted for more than 60 days during last 10 years prior to investment in payment

<i>State and affected category</i>	<i>Restriction</i>
<b>New York :</b>	
Savings banks.....	of principal or interest on any debt. For non-New York State cities, investment in is precluded if a default for more than 120 days in the 25 years prior to investment. Does not cover New York State cities.
Banks (other than savings banks) and trust companies.	Investment precluded if securities to be acquired are in default as to principal or interest at the time of acquisition.
Insurance companies.....	Reserve investment precluded if securities to be acquired are in default as to principal or interest at time of acquisition.
<b>Ohio :</b>	
Fiduciaries .....	Investment in non-Ohio city bonds subject to Prudent Man Rule. For Ohio city would be a precluded investment if city had defaulted for more than 120 days in last 10 years. Under the Prudent Man Rule, default by non-Ohio city may bar further investment in securities of that municipality.
Savings banks.....	Investment precluded if city has defaulted for more than 90 days in last 10 years.
Insurance companies (life)---	Investment precluded if securities acquired are in default as to principal or interest at time of acquisition.
Insurance companies other than life.	Investment precluded if municipality had defaulted in payment of principal for a period of more than 1 year, or payment of interest for more than 120 days on any of its securities, within 10 years preceding the investment.
<b>Oregon :</b> Guardians.....	Without court order, cannot invest in bond of Oregon city which has defaulted within last 5 years for any period. Seems: Non-Oregon city bonds are never a permitted investment.
<b>Pennsylvania :</b> Fiduciaries (guardians, committees, trustees and other fiduciaries subject to jurisdiction of court of common pleas, not including personal representatives.	Investment precluded if municipality is not current in payment of any part of principal or interest owed by it on any part of funded indebtedness on date of investment.
<b>Tennessee :</b> Trustees, guardians and fiduciaries.	Cannot invest in any municipal bonds if defaulted for more than 30 days in last 25 years on principal or interest of any debt.
<b>Vermont :</b> Banks.....	Can invest in bonds of cities outside of Vermont if issuer not in default at the time of investment.
<b>Virginia :</b> Executor, administrator, trustee or other fiduciaries.	Investment precluded if security to be acquired is in default or has been in default for more than 90 days; investment precluded if city has been in default on principal or interest of any security issued by it for more than 90 days in the last 20 years.
<b>Washington :</b> Insurance companies.	Investment precluded if security to be acquired is then in default in any respect at time of acquisition.
<b>West Virginia :</b>	
Trustees, executors, administrators, guardians.	1. State bonds are impermissible if any default in last 10 years. 2. City bonds are always impermissible.
Trust companies.....	1. Usually a limitation placed on investments in any security; but 2. No limitation on city bonds if city has not defaulted in last 10 years.
<b>Wyoming :</b> Guardians.....	Cannot invest in city bonds if defaulted for for than 30 days in last 10 years.

Mr. MILLSTEIN. That is not complete. We did that hurriedly last night, but we do have the reference source so you can get Prentiss-Hall and CCH and your staff can track that down themselves.

The problem we see—and the problem Mr. Lewis is going to talk about briefly—is the issue of, even after you come out of default, even after these horrible events get solved and we manage to reach a compromise with the creditors some day, we are still not finished because we have to live with all of the State laws which make our paper non-legal paper—it can't be touched by some banks—a lot of insurance companies won't be able to touch our paper for 5 to 10 years.

What I am concerned about is not the 30-odd States I have given you in the memorandum and the others we mentioned hurriedly last night, but I am afraid if we go into default we will have a rash of laws around the country, and the States which took action and say no, don't touch New York paper—

The CHAIRMAN. What you give us—what this amounts to in terms of protection—would it be half or a quarter of the market?

Mr. MILLSTEIN. I have no idea. I know in California no commercial bank would be able to touch our paper for 10 years. What does that mean? I don't know.

Ohio is one of the States where insurance companies wouldn't be able to touch our paper for 5 years. I can't quantify it.

The CHAIRMAN. Do you care to make a judgment that the fact that you would not be legally acceptable in California might have a chilling effect on banks elsewhere?

Mr. MILLSTEIN. Yes, I think it would have a chilling effect on banks elsewhere and I don't think it would take long for other States to enact comparable laws once New York City, that prime example, went into default. I think suddenly, State legislatures across the country would duplicate the list I have given you and other banks in other States would be prohibited from touching us.

As Mr. Lewis said last night, why would anything want to pick up a New York piece of paper after we come out of default when triple-A bonds are all around the country?

The CHAIRMAN. Can you give us any notion of how long this might be?

Mr. MILLSTEIN. In California it is 10 years; in some States it is 2 years. It ranges State to State. In one State it is 25 years that you can't touch the paper.

The CHAIRMAN. What State is that?

Mr. MILLSTEIN. We will find that. I am told only 20 percent of our paper is sold out of our State. It is 20 years in the District of Columbia, for example. In New York, amazingly enough, we have a rule about non-New York municipalities defaulting, and it is 25 years.

[Laughter.]

The CHAIRMAN. Then your prediction on how this is likely to be picked up around the country is a good one.

Mr. MILLSTEIN. It is very real. States are going to say, we have to protect everybody. It has happened. It is incredible.

But I thought you would want the details. This is not the ripple effect; this is State law. Of course, while we are in default, of course nobody is going to touch us.

The CHAIRMAN. Do any of your colleagues wish to make a statement?

Mr. MILLSTEIN. Mr. Lewis wanted to speak about the so-called prudent man testimony.

Mr. LEWIS. I have been asked to state whether a fiduciary, an executor or a trustee under a will would be willing to or be in a position to buy New York City bonds after a default.

My immediate response was if I were asked as a fiduciary, and I am a fiduciary on a great many estates and trusts, I would not for a period of 8 to 10 years buy New York City bonds after default, and then only under very, very special circumstances.

Now, the prudent man rule, which you heard about earlier this afternoon, talks about acquisition of securities by a man of discretion and intelligence in such matters who are seeking reasonable income and preservation of their capital.

As a prudent trustee, I would avoid New York City bonds after default, because I have been placed on notice that they did default. Who knows when they will default again, and when the State of Maryland, and the State of Vermont, the State of Texas, the State of California—Triple-A bonds are available, States where there is no possible discussion about default—why would I, as a trustee, subject myself to the chance of liability of criticism by investing in New York City bonds.

Senator BIDEN. Mr. Chairman, may I ask a question on that point?

The CHAIRMAN. Yes, indeed.

Senator BIDEN. Sir, why, as a prudent investor, would you do it after the Federal Government guarantees the loan?

Mr. LEWIS. There is a tremendous difference between that situation and a city in default. Marginal credit suffers first, and a lot of discussion was held this afternoon about the State of Maryland bonds can readily be purchased and sold.

Of course, it is a triple-A bond, but you can't compare that or a State of Texas triple-A bond with a New York City B-rated or not rated at all bond which has already—a city which has already defaulted.

That is a great difference.

Senator BIDEN. My point is although there may be a difference in degree, isn't it a fact that that is going to be the case anyway, whether or not there is default after the 3-year term expires.

Mr. LEWIS. Forgive me, not if we have the U.S. Government guarantee.

Senator BIDEN. What happens after the guarantee is over?

Mr. LEWIS. Maybe by that time the city of New York will have reconstituted itself and investor confidence will be reestablished.

Mr. MILLSTEIN. I think what Mr. Lewis and I believe is that a Federal guaranteed piece of paper will sell today and will be bought by fiduciaries and others. If we don't go into default, there is a hope at the end of the third year, when the city balances the budget, the city can face the markets again.

I am troubled if we do go into default, even with Federal guaranteed bridge loans, that default in and of itself is an act that will keep us out of the market for many years to come because of the reasons I have just outlined, the litigation, the effect of the U.S. laws and there is not end.

I don't know when we could face the markets. I don't care about the financial people now; I am not talking about them. I am talking

about the lawyers and trying to get out of that default, climbing out of a Federal court. It is not easy.

Mr. LEWIS. The city of Detroit, as you know, defaulted in 1933. The city of Detroit was not able, I am told—I was not active then—was not able to sell its paper for 8 years, but it existed by reasons of selling its paper to the Reconstruction Finance Corporation, here again, a Federal agency.

The CHAIRMAN. Gentlemen, thank you very much—I beg your pardon, Senator Stevenson.

Senator STEVENSON. Would the same objectives apply with an 80 percent guaranteed obligation?

Mr. MILLSTEIN. That is not my field, Senator. I just don't know.

Senator STEVENSON. Do the State statutes say the obligation of a defaulted government is acceptable if it is guaranteed by the United States?

Mr. MILLETEIN. If it is 100 percent guaranteed?

Senator STEVENSON. Yes. Do they say that?

Mr. GOLDIN. Senator, the statutes don't cover that situation. They merely specify, in talking about a security either issued by or guaranteed by a municipality, that security will become ineligible for purchase by the particular class of fiduciary if there has been a default of more than "x" number of days in the last "x" number of years.

Senator STEVENSON. So even with a guarantee, it would be ineligible.

Mr. MILLSTEIN. The important fact is the fact of default.

If we don't default, the statute doesn't take effect. That is the point.

Senator STEVENSON. I see.

The CHAIRMAN. Thank you very much, gentleman. We appreciate your expert, helpful testimony.

The CHAIRMAN. Our last panel consists of James S. Abrams, vice president, Allen & Co., Inc., New York, Frank K. Spinner, senior vice president, First National Bank of St. Louis and A. Robert Abboud, deputy chairman of the board, First National Bank of Chicago.

**STATEMENTS OF JAMES S. ABRAMS, VICE PRESIDENT, ALLEN & CO., INC., NEW YORK, N.Y.; FRANK K. SPINNER, SENIOR VICE PRESIDENT, FIRST NATIONAL BANK OF ST. LOUIS; AND A. ROBERT ABOUD, DEPUTY CHAIRMAN OF THE BOARD, FIRST NATIONAL BANK OF CHICAGO, ACCOMPANIED BY MR. VAUGHN**

The CHAIRMAN. Mr. Abboud, you and I have met, I think, about 4 or 5 months ago.

Mr. ABOUD. We did, indeed, in Chicago.

The CHAIRMAN. Gentlemen, if any of you have statements, you may go ahead.

Mr. ABOUD. Senator, may I introduce Mr. Vaughn, vice president of our municipal securities division at the bank, who is accompanying me.

Senator, I have a statement that takes about 15 minutes. I apologize that I don't have it written down, as I was writing some of it on the margin coming down here, but I would like to go through it with your permission.

The CHAIRMAN. We understand this is short notice, and we appreciate your coming at all.

Mr. ABBOD. The problems besetting New York City stem from the excesses which have been detailed by many of the speakers that have appeared before you. Such excesses include off budget financing, a pension system that is unsustainable, a hospital and college tuition system that is unsupportable, large municipal payrolls and still other acts.

"The Wall Street Journal" editorial of October 20 addresses some of these issues, and if these facts as reported in "The Wall Street Journal" editorial are accurate, please note, of the \$2.4 billion spent by New York City to cover social services, only \$600 million of the expense is directly borne by the city, or 25 percent.

By comparison, the debt service alone last year was three times this amount, or \$1.8 billion, according to the editorial.

By comparison, the total debt of New York City was \$13.2 billion compared, for example, with the total debt for Chicago of about \$1.6 billion. The annual debt service requirement for New York was a little more than the total principal of the Chicago debt. Admittedly, of course, the population of New York is two and a half times larger than that of Chicago, but the debt proportion is larger than that.

It appears to me, as a banker, that the debt total is already too large to be properly serviced on the present revenue base. The present maturity of that debt is too short. The debt service requirements, including interest, are too heavy and absorbing too much cash.

In my opinion, it was unwise to issue securities bearing coupons of over 9 percent, tax free, which by their issuance established a new price reference of other bonds and added disproportionately to the overall interest expense. I believe the two issues facing this committee are one, is a solution possible which does not include Federal guarantees?

Would there be a financial collapse if New York City voluntarily reorganized?

As to the first question, the situation appears to be no different from that of any borrower who has simultaneously borrowed too much and permitted his earnings base to erode. The classic banking solution is to restructure the debt. To extend the maturity, reduce the interest rate and surrender a small percentage of the principal, perhaps.

Second, to require that expenses be cut by scaling back on costs and increasing revenues by broadening the tax base; if costs cannot be cut materially and/or revenues increase, then we do not have a viable business, no matter how much more money is injected into the New York situation.

We ought to face the issue squarely as to whether the rest of the Nation wishes to provide what could be a permanent subsidy to New York City. The difficulty in the present situation is the deep feelings and emotional involvement of all of us, as we try to search for solutions. I suggest we should get away from fingerpointing and the choosing of sides and endeavor to search for solutions to the real and complex problems involving both money and people.

I respectfully suggest we are impaling ourselves on a cross of definitions. We are asking ourselves the wrong questions. The present choice suggests that New York either defaults and invokes the bankruptcy laws or should get funds to pay out all obligations on terms as originally contracted.

No one wants to be labeled a bankrupt or even to default. The pressure to sustain a debt and credit structure which is unsustainable. What we need is an alternative choice. We need a mechanism for which legislation must be passed to permit New York City or any other city or political subdivision to voluntarily restructure its outstanding credits on more realistic terms, to make it possible to pay everyone out in orderly fashion.

It will be a great boon to many cities if there were legislation for voluntary restructure in which outstanding credits would be held in place, pending completion of a plan of reorganization, and thereby avoiding the stigma of bankruptcy which is not at all descriptive in this situation.

It remains a going city and a very vital city. Just as it occurs in the best of families, and it happens with individuals and business, the terms must be lengthened and the interest rate reduced or what have you, and we need a mechanism for doing that.

As for a proposal on a voluntary restructuring of New York City, we could consolidate the debt and request the holders of the debt to accept a new security to be paid out over a 10- or 20-year period. Establish a new coupon. Agree to give up some of the principal on the debt up to a maximum of 10 to 15 cents on the dollar, but only if there is a comparable adjustment by municipal employees, policemen, firemen and teachers who would agree to cut payroll cost by 10 to 15 cents by reductions in salaries or reduction in work force level and agreement by appropriate authorities to increase the revenue base by 15 percent. This then distributes the burden over three constituencies. In addition, such partial forgiveness of principal would only be operative if and when the pension plan was restructured, the expense of the city hospitals was reduced and tuition charged for the city colleges. Such a plan should bear the approval of trustees, two people representing the creditors, two municipal employees, one person representing the city and one person representing the State. That is just a suggestion.

In return for the creditors' cooperation, the Federal Government might agree to some kind of plan whereby the coupons on the new securities to be issued for the existing debt would be available as a tax credit on corporate or individual income tax returns, if not paid when due. Such coupons would have to be presented with tax returns and would constitute a prior lien on all revenues received by the city in favor of the Federal Government. The availability of the tax credits would insure that interest on the securities would be paid in a timely fashion and would insure a market for the new securities.

Additionally, it would keep the Federal Government from establishing a precedent whereby the Federal Government would guarantee obligation incurred by the States and municipalities. The Federal Government could agree to make temporary advances of cash in the nature of trustee certificates as is typical in other reorganization cases. Rather than guarantees that would be disadvantageous in many, many ways, these direct advances would be senior to all other debt, accrue interest at the 90-day Treasury bill rate and be paid out before interest and principal were paid on any other debt.

While any amounts were outstanding the administration and management of the city would be subject to direct control by a creditors' committee to be organized in any way the Congress may deem best.

Now, there are several reasons for not establishing a precedent of guaranteed municipal obligations, as far as principal is concerned.

Once it starts, it is difficult to stop. Involvement of the Federal Government at the State and local levels in financial matters invites control and will gradually erode home role. We want less government in our lives, not more. The municipal tax exempt market is a long-established market. If we introduce a new class of securities guaranteed by the Federal Government and taxable, it raises a new dimension of sovereign political risks. Would these have priority over the existing obligations and would you have a situation where a poorer credit risk would trade at a better rate. Admittedly, a special allowance of a tax credit on the new extended securities poses risk in this area. We want to make sure we are giving the creditors better paper than they now hold in return for the concessions outlined above. It is a one-shot deal. The penalties associated therewith would have to be accepted. The purpose is to calm the credit market by signaling that the vast amount of the principal of these securities remains intact and the actual loss is modest, if calculable.

The Federal Government is in no position to give permanent money to anyone. The Federal deficits are continuing at an exceedingly high level. The financing of the national debt is a serious problem which should not be aggravated by taking on new permanent obligations which would become open-ended.

With regard to the second question, would there be a financial collapse if New York City requested voluntary reorganization? If there were a program such as the above, there would be no financial collapse, in my opinion.

There would be a great relief and strengthening of the credit market. The creditors would be assured of receiving good paper on a scaled-back basis. The country and the world would be assured we have the courage to face up to our problems head on.

In fact, I respectfully suggest that we face eroding confidence if we don't meet the problem realistically and meet it fast. This is a strong, vital, imaginative country. We are on the threshold of restoring our financial leadership throughout the world.

We have nothing to fear in taking the right steps and addressing the problem calmly and realistically.

The CHAIRMAN. Thank you very much, Mr. Abboud.

Mr. Spinner?

Mr. SPINNER. I will be a little repetitious.

Although I didn't get into a detailed plan, it appears we both are in agreement. My expertise, if there is any at all, would be the fact I have the responsibility in our bank of the bond department as well as the investment portfolio.

I have spent two-thirds of my 28 years in banking in the area of investments.

A recent survey within the last month by Singlinger, who asked a number of questions in different ways as to whether New York City should be bailed out, two-thirds to three-fourths of the people who responded said no, New York City should not be bailed out by the Federal Government; it should be allowed to default.

There is a possibility if New York City goes, that New York State could go also, for different reasons, obviously.

I feel the same thing here. My reasons are very basic.

First of all, I don't believe the world will come to an end. The market has already shown it can live with this controversy. The most disturbing part to the market today is the fact it doesn't know what will happen. Markets can live with bad or good news, but they have a terrible time adjusting to uncertainty.

Whatever your deliberations are, I hope you do it quickly and decisively so everybody knows what is happening. I hope you don't play with this thing until December 1 because that would not be a good way to handle it.

If you bail out New York City, I see no reason why any school district, school board, county supervisor, mayor, should balance their budget. What is the incentive for them to balance their budget every year? You must make up your mind to be reviewing a lot of other people if you do this. The first time you announce the bailout, you will probably have visits from 5 or 10 other cities. I see no reason why they shouldn't be here also. It is important to—I wonder if it was Chicago—I don't know why I picked that one—if Chicago was having this problem, whether the committee would be meeting today.

Mr. ABBOUD. We don't have that problem.

Mr. SPINNER. Somebody said they should lend Mayor Daley to New York City, and I concur. Chicago balances their budget beautifully. I do not believe if Chicago was in the same shape as New York City today, that this committee would be concerned about it. Chicago is one of the best run budget-balancing cities in the United States. I am just using that as an example. I don't know where you draw that line.

Another thing bothers me as an investor in municipal bonds. I have made terrible mistakes in the recent years, based on what may be happening. I have avoided credits for our bank's portfolio that I thought had the possibility of getting in trouble. If you bail out New York City, I have made a terrible mistake. I should have run around and bought the lousiest credit I could find because I would get a good return on my investment and at the same time I would wait for you gentlemen to make it a Government-guaranteed security, if it is a large enough investment. It is not what you are doing today, but what will the impact be?

Another problem I have is if you reward fiscal irresponsibility and if the Tower amendment prevents me from getting financial information from the issuer of municipal bonds, I will be forced to buy my bonds regionally. I will have to buy municipal bonds from the people I can get in contact with, know, and have confidence in.

Anyone else, I will have great difficulty investing the bank's money.

Obviously, New York City's problems are two-fold. One is the balancing of the budget. The other is a bad cash flow.

In addition to the normal problems, New York City has for years floated their debt over a 5-year maturity. That was their effort to save interest costs. When most municipalities issue bonds, it is for 20 years. There is no way other cities get into trouble with the way they do it. New York City didn't do that.

A large portion of general obligation bonds that mature each year must be refinanced. How do you balance your budget? It's easy. You raise taxes, and/or you cut expenditures.

If you expect—in my opinion, if you expect the people who run New York City to go back to the unions and ask those people to take a cut in pay, bite the bullet, if you want the citizens to pay more taxes, if you want all of the people to bite the bullet, then you should go to the bondholders and say, “You, too, must bite the bullet.”

The bondholder has been getting paid for years, 1, 2, 3, 4, percent more, tax-free. Why did he think he was getting that? Where, all of a sudden, is this innocence? The market does not make gifts. It never has, and it never will.

I have little sympathy for the people who bought New York City bonds. For any widow or orphan who holds New York bonds, I think the person that advised them is the one who should get involved here and not the Federal Government.

We are about to reward the bondholder who has bought a credit at substantially above the market interest rates at yields higher than the rest of the market. We will reward this group of people who took a businessman's risk. They have lost. Now they are crying, “You have to bail us out. We didn't know.”

I don't believe it. If that is true, they were naive. I don't think the bondholders should avoid biting the bullet along with the employees of the city of New York. I think other people should pay their fair share also.

The banking industry is aware of how to restructure debt. We are doing it with the REITS. We are giving them interest rates below the market and extending maturities.

This is what has to be done with New York City bondholders. They have to be able to sit down and renegotiate. It is the way municipalities solved their problems in the 1930's.

The State of Arkansas defaulted. They even issued small maturing dollar amounts of bonds with a number of years' interest to get themselves on proper footing. Today Arkansas is a Double A bond.

S. Louis, biState authority, when its transportation system defaulted a year or two ago, we went out and raised a local sales tax of half a percent. I think the city should have taken care of their own problems, and it did.

The bondholders should have paid part of the price. I think that is wrong, and it will be wrong in New York City to do the same thing.

The stockholders of institutions that bought more than reasonable amounts of these bonds should suffer, to some extent. They will suffer by getting new bonds at lower interest rates. Their earnings were overstated in prior years. They should pay that today.

Politicians should suffer because the power of spending money should be removed from them completely until the problem is corrected.

In my opinion, default is the only common sense approach. If you bail out New York City, you open Pandora's box. If you guarantee New York City bonds, in my opinion, you had better be prepared to guarantee its entire debt.

I see no reason why in the next 3, 4, 5, 6 years, anybody will buy New York City bonds when they know if they don't, the Govern-

ment will have to guarantee them. That is something we should give a lot of thought to.

If you are going to bail them out of this situation, I would just as soon have you appropriate \$6 billion and give it to them. Perhaps you should give them some of the Federal surplus.

Now, let's solve this problem for a change instead of gimmicking it, patching it, and acting like it isn't there. Defaults have happened. They have been many years ago. We lived through them. The world didn't come to an end.

For our own good and the future of the country, I believe that the best long-term solution to the city of New York problem is to let them default, go bankrupt, and restructure the debt, and get the budget balanced. I think you can balance the budget a lot quicker when you are in default rather than if you allow the politicians to bail them out.

Whatever you do, gentleman, I hope you do it quickly.

Thank you.

The CHAIRMAN. Thank you, Mr. Spinner.

Mr. Abrams.

**STATEMENT OF JAMES S. ABRAMS, EXECUTIVE VICE PRESIDENT,  
ALLEN & CO., INC.**

Mr. ABRAMS. I am James S. Abrams, manager of the municipal bond department of Allen & Company.

That I not be misunderstood in my succeeding statements I wish to make it understood that the default by New York City on its bonds would have serious consequences and that the impact on all financial markets could be disastrous.

The purpose of my testifying before this committee is to propose a financial reorganization of the city's finances. I suggest that the city employ a group of financial banking firms on behalf of the city to make an exchange offer to the owners of the presently outstanding New York City notes maturing December 11, 1975 through June 11, 1976, totaling \$2,800,000,000 for a 10-year New York City general obligation bond issue.

This issue for a matter of discussion in general would carry an interest rate of 9 percent and have a sinking fund starting in the fifth year. The sinking fund retirement amounts would be determined by the amount of moneys that would be available. The second step would be provided by an issue of New York City bonds to be pledged with the Federal Reserve Bank in an amount to provide funds for moneys needed to make up the deficit in the city's budget at this time. Suggestion is that these bonds mature in 15 years and at an interest rate to be negotiated between the city and the Federal Reserve Bank.

I have a great deal of confidence that the exchange of bonds for notes as described previously could be accomplished. The estimate of costs necessary to put through this exchange would not be more than 1½ percent of the principal amount of bonds exchanged.

I will answer any questions you may have.

The CHAIRMAN. Thank you very much, gentlemen, for your assistance.

We had yesterday—and I think I should clear the air on it—we had a statement by the Senator from Illinois that Chicago bankers have

been intimidated. I think I understand now, but I don't think it has been made public and clear what was meant by that. I did not act as I should have as chairman to clarify the significance.

Mr. Abboud, has there been any attempt to intimidate you or anyone else in your bank?

Mr. ABBOUD. None at all, Senator; I don't intimidate easily.

The CHAIRMAN. Has there been an attempt to intimidate any other person in the bank?

Mr. ABBOUD. No.

The CHAIRMAN. Would you know it if a top official of the First National Bank of Chicago had been approached? Would they tell you?

Mr. ABBOUD. I would, Senator. In a difficult situation like this where obviously all our sympathies are with New York and the people of New York or anybody who is in trouble, people are reluctant to try to get in and do something about it. I distinguish that kind of reluctance and awkwardness from what I gather may be behind your feeling.

The CHAIRMAN. I called Mr. Perkins, who is president of the Continental Illinois Bank. He said he had not been approached or intimidated in any way. That is the other large bank in Chicago.

Mr. Philip Sweet, chief executive officer of Northern Trust, indicated that he had not been approached or intimidated. He was sure no one else in his bank, just as Mr. Perkins said, no one else in the Continental Illinois Bank had been influenced.

Mr. Murray, the chairman of the board of Harris Trust, the fourth largest bank in Chicago, said the same thing.

Senator Stevenson and I had a discussion last night that clarified it. Senator Stevenson's intention was not that New York bankers had talked, or used any overt pressure of any kind, but just the existence of a situation where Chicago bankers would want to preserve good relations, would tend to dissuade them from appearing before the committee. That was the nature of the effect on Chicago bankers.

Senator STEVENSON. Mr. Chairman, what I said was true. What I said was that bankers are intimidated. That has been confirmed to me in person by banker after banker after banker. It has been confirmed by the experience of this committee. Mr. Spinner wouldn't be here if he hadn't read that statement which said bankers are intimidated. They responded by saying, "If they can't get others, I will come and testify to what has been testified to for the first time." I can elaborate and I don't mind putting names on the record.

One banker, the chairman of one bank in the city of Chicago, was so intimidated that he wouldn't even permit an official of his bank whose services I sought because I have confidence in his services, to work in private in this committee and help it.

The CHAIRMAN. What was the name of that banker?

Senator STEVENSON. He is the former president of the American Bankers' Association, Allen Stults, the chairman of the American National Bank in Chicago.

The CHAIRMAN. He was interviewed by the press and said he hadn't heard one word from the New York bankers.

Senator STEVENSON. New York bankers do not have to go out and threaten.

The CHAIRMAN. That is what I want clear.

Senator STEVENSON. I said they are intimidated.

The CHAIRMAN. My interpretation of that—and I have discussed this with the staff and others—they thought when you said intimidated, they thought there had been an overt effort by word or some kind of threat to keep them from appearing.

Senator STEVENSON. I not only used that word quite properly but I enlarged upon it by explaining. It was reported by the press that they were scared. They didn't want to rock the boat. That, Mr. Chairman, is the truth.

The CHAIRMAN. I think it is clear that the Chicago bankers had not been approached. I think it is clear in the semantic brambles we find ourselves. Senator Stevenson interprets the position of Chicago bankers as being one of intimidation.

Senator STEVENSON. Not Chicago bankers—American bankers.

The CHAIRMAN. I have more trust in the courage and integrity of American bankers.

Let me ask you, Mr. Abboud, back in 1971, were you an officer of your bank?

Mr. ABBOD. Yes, sir, I was.

The CHAIRMAN. You testified before the House committee at that time in favor of the Lockheed loan guarantee. I mean the officials of your bank did. They participated in that to the extent of 3.75 percent. Did you object to that participation by your bank?

Mr. ABBOD. Senator Proxmire, I objected to that action; I objected to the action of the Federal Government taking a hand in the Penn Central situation and having been directly involved in the Penn Central situation. Since June 1970, I have known of no situation where the Federal Government has come in, in order to perpetuate a company and thereby to retard the surgery that has to generally be done in these types of case. I know of no situation where it has worked.

The CHAIRMAN. I congratulate you on that position. That was the position I took. Unfortunately, your bank didn't take that position.

Mr. ABBOD. I was not running the bank at that time, sir.

The CHAIRMAN. All right, sir. You are calling for, in your interesting plans, a voluntary reorganization of the city's debts; is that correct, sir?

Mr. ABBOD. That is true, sir.

The CHAIRMAN. What about the noteholders who don't accept the voluntary plan?

Mr. ABBOD. Under the plan I propose, Senator, it would not be limited to New York City. It would be an amendment to the general reorganization and bankruptcy statutes under Federal law that would take precedence over State law and would be available to any political subdivision that wanted to use it. It would be a voluntary restructuring where a municipality or State or political subdivision could file and go in there.

The act of filing would bind all of the creditors and would freeze the debt at that time, something like chapter 11 does for corporations.

Then you have a workout. That includes everybody.

The CHAIRMAN. The mayor of New Orleans, in testifying on this matter—and he is president of the National League of Cities, I believe—rejected that as the wrong route and one that would make it

extremely hard to sell municipal bonds with anything like the interest rates they now have.

If you have cities going into bankruptcy, he thought it would be extremely difficult for those who kept their houses in order. What is your reaction to that?

Mr. ABBOD. Senator, first of all, I take issue with the suggestion that the plan that I have proposed makes bankruptcy easy. It is a reorganization which is something less than default in bankruptcy. It is the normal activity participated in by individuals and businesses. A day doesn't pass but what we don't have a borrower coming into say, "I'm over extended, I want to lengthen the maturity; I want a new loan; I want to restructure the interest rates."

The CHAIRMAN. Isn't it true that the fact the cities don't do it, that they can't go into court without an approval of note holders, isn't that one of the reasons municipal bonds have been in the past such a good investment?

Mr. ABBOD. First of all, you are referring to chapter 9. I agree that chapter 9 is deficient. I think it needs a restructuring and a new statute. I propose there be new legislation. I have confidence that you can whip out such new legislation in fairly short order. I would not say because it is difficult for them to get into this kind of restructuring arrangement that it has made municipal obligations more attractive. On the contrary it has provided a situation where you have been able to build water into the situation. Now we are paying the penalty for that. We need a device to squeeze the water out.

The CHAIRMAN. Hasn't it been with the exception of what it is in New York that has been *sui generis*. Hasn't our experience under the present law been favorable? The failures have been of small dimensions. As I understand it, since 1945, bond and note holders of municipal securities have lost less than one-half of 1 percent in their principal in all the defaults that have taken place.

Mr. ABBOD. You have had a period where the amounts of municipal debt has not escalated to any degree near what it has in the last 5 years. When you say the experience of New York is *sui generis*, that is only a matter of degree. The inflation that has occurred in the country over the last 5 years, the increase in expenses, the new attitudes of Government that have overpromised those, have encouraged cities and States to go out and extend too much debt. When you get a situation where you have too much debt you need a device where you can wring out the water. You can wring it out comfortably without either incurring the damage or disgrace of default or bankruptcy and at the same time give you a realistic posture so that you are not swamped by inordinate debt service.

The CHAIRMAN. Isn't it extraordinary that all the people, the distinguished Senator from New York, for example, who is here, the mayor, Governor, all of the bankers, all of the people closest to New York, all would like to follow the proper course; but all the people who are involved in this would prefer the tough terms that we provide? They have to balance their budget in 3 years. They will have the toughest supervision. The State will have to increase taxes. The financial community will have to take 20 percent of the \$6 billion that we would guarantee without any guarantee on that billion dollars they take.

They are willing to go down this tough course, rather than default because they argue and you have heard the argument over and over again that once they default they are out of the credit market for a long time to come, maybe for 8 years like Detroit and maybe for a generation.

Mr. ABBOUD. First of all, I have great admiration for the distinguished Senator from New York, whom I have had the privilege of meeting on several occasions and I admire him greatly. I have great respect and admiration for the bankers in New York. They are the finest in the world. I think the difference in the program they would propose, which has the same consequences as the program proposed here, is that here would be a formalized mechanism suggested in this program and it has been by experience in the baking business, if you don't have a formalized mechanism you turn around one day after another and you find more threads unraveled. We have been through a couple of years when we have been reorganizing the leasing companies and God knows what else—retailers and so forth—and it is very, very difficult to keep a group of creditors in line and all on the same course unless you have some sort of a mechanism that holds them in.

It is because of that that the revolving credit agreement in which everybody participates and the covenants and terms and conditions has come into such popularity. That is the device by which you tie everybody in. In this situation where you have many holders spread all over the world you need a formalized mechanism. I don't think you will get anywhere until you establish it.

The CHAIRMAN. Let me point out that you would require two pieces of legislation in effect. New bankruptcy legislation, a tax credit which is far more complicated than simply providing a taxable bond and therefore would require hearings.

Mr. Abrams has reminded us that is important to get a decision one way or the other. No assistance or assistance of a certain kind.

I think you would all agree something is necessary quickly. That is, within a few weeks. Not on December 1.

Mr. ABBOUD. There would have to be two pieces of legislation. They do not have to be simultaneous. The tax credit, once you have established a mechanism by which you can accomplish a reorganization—that matter can be deliberated over a period of weeks, and most, because those new securities would not be issued until you have been able to figure out what the revenues will be or the expenses can be cut and so there is time to do that.

These do not have to take place at the same time.

With regard to the new legislation under the bankruptcy laws, I must say, Senator, I object to the word "bankruptcy." I'm not suggesting a bankruptcy mechanism. I'm suggesting something that falls short of bankruptcy and should not carry the stigma of bankruptcy.

The CHAIRMAN. My time is up, but in fairness, you will be considered by some to be a disinterested witness. By others, you would not be. I want to give you a chance to respond to why you would not be.

You are a Chicago banker. You have one of the biggest banks in the country outside of New York, and, of course, the big bank in

California. Some people might consider that the big CD-holders and others might flee to you in the event of a New York City default.

Chicago banks might prosper considerably on the basis of this. I am sure you won't want that kind of prosperity, but this would be the kind of consideration that some people might feel Chicago bankers might experience.

I would like you to respond to that particular credibility problem you may have.

Mr. ABBOD. I welcome the opportunity to respond to that because I don't believe that that would be the case.

First of all, the New York banks are not New York banks. They are world banks. They have assets and income streams all over the world. The major banks involved in the money center CD market would not be affected by this.

There has been great currency in the press that the banking system will be shattered, crumble, and fall because of this. That is not true. Banks, whether in New York or elsewhere, have been prudent. It is not good for anybody to do that. We all belong to the same industry. We cannot feed off each other. That is counterproductive in every way.

The reason I am suggesting something along these lines is because I think you would cure the malady much faster and get it back on sound footing. That is the purpose of suggesting this.

My own subjective opinion is that the other course drags it out, like Penn central, and you will never get a solution.

Senator PACKWOOD. Someone made reference to municipalities defaulting in the 1930's, and even the State of Arkansas. What happened when they defaulted? What was the process of reorganizing?

Mr. SPINNER. In Arkansas they restructured the debt, like we have been talking about. Not only did they put the debt out far enough to get organized again, but they took a number of years' interest and gave you a bond in lieu of the years' interest, so there was a period of time when they had no payments or interest on the debt.

Senator PACKWOOD. There is a compulsory process that the debtor can undertake whether or not the creditors like it?

Mr. SPINNER. When they are faced with the alternative of refinancing or what else, which is a bigger question mark, good, commonsense would dictate that they take the lesser of the two evils.

Senator PACKWOOD. From what you are saying, in New York's case, if Congress did nothing, that would be the alternative New York bondholders would be faced with. They would have to accept reorganization?

Mr. SPINNER. I would think so. Since they have been rewarded with high interest rates, I don't see why they should be rewarded again by being paid off.

Senator PACKWOOD. If we do nothing in Congress, the bondholders would have to accept reorganization. What are your opinions?

Mr. ABBOD. If you did nothing, Senator, obviously there would be a default and there would have to be reorganization.

Mr. ABRAMS. My plan calls for no default and voluntary exchange of credits.

There are only two matters that got New York City in this position. It is the short-term borrowing that was coming back due in May or June and a tremendous cash flow that it has taken out of the State

financial resources. Were it not for that, there would not be this problem.

Senator PACKWOOD. We have options 1, 2, 3, option X. If we don't undertake any of the options, we are not going to be faced with a situation of New York bondholders going begging. There will not be a bankruptcy in the sense of discharge, tough luck. That is not a possibility?

Mr. SPINNER. That is correct.

Senator PACKWOOD. We are not, then faced with a situation of the word, "bankruptcy," in the sense we normally understand it in business, where you would get 20 or 30 cents on the dollar?

Mr. SPINNER. When you are talking about general obligation debt, that is true. In revenues it is different.

Senator PACKWOOD. I was going to come to the revenue. I am curious about the legal opinions. Who has the first claim on New York City revenues?

Mr. SPINNER. The lawyers don't agree. This is a question whether you can operate and take care of the bondholders, then. Some contend the bondholders come first. From a practical standpoint, you have to meet the payroll. That is commonsense, and that is a thing of the past.

Senator PACKWOOD. No matter what the bond says, the million public services will come first.

Mr. ABRAMS. I disagree that things could not happen. A bondholder can mandamus the courts to levy sufficient taxes to pay the interest and principal on his bonds. That is the same as putting somebody in bankruptcy. If they do do that, the tax levies would have to be so high that they would not be able to collect them from the people that own the properties.

Senator PACKWOOD. Which brings us back to the situation where the bondholders—

Mr. ABRAMS. I can tell you of 20 cities that did that.

Senator PACKWOOD. The bondholders, then, will have to accept re-composition. If they go to court and the jury says 50-percent increase in real property taxes, and the people abandon their properties, and there is no money, that is not solution for the bondholders.

The realistic effect of that is happening is that the bondholder still doesn't get his money.

Mr. ABRAMS. In time they did. In the city of Miami they were mandamusd to make levies. They secured court orders to raise the taxes in 1932. Luckily, the financing at that time, that the economics grew so rapidly they were able to absorb those additional taxes.

Senator PACKWOOD. Let me change tack just slightly. As long as we are all presuming that the bondholders in one way or another will be paid, whether we give a guarantee, adopt a reorganization plan, do nothing, we are not, therefore, talking about default, bankruptcy, no payment.

With that premise, what will the effect on other municipal bond markets in this country be if this Congress does nothing? Any of you. All of you, preferably.

Mr. ABBOD. Senator, it is my personal opinion, whether you do nothing or you do something, that this market will adjust and that after—

Senator PACKWOOD. I understand that.

Mr. ABBOOD. The effect in the first instance will be to try to assess the uncertain. When you are assessing the uncertainty, there will be a reduction in the price of municipals and yields will go up, and they will gradually come back to what they are supposed to be. There will be a greater discrimination among the municipals, and this is so.

The problem that I would have with that is that I think New York is a going entity, a going operation. It happens to have encountered a situation where there is water in its debt structure. There is more debt than the revenue base can support.

There are only three ways to remedy that.

One is to reduce the debt, increase the revenue, or cut the costs. In my opinion, there ought to be a mechanism available to do all three of those things at the same time. If you have that kind of mechanism, and if the city voluntarily did that, I think the impact on the market would be beneficial, rather than to have a situation develop where the impact on the markets, even for a short time, would be adverse. And since we do have a going business, why not provide them with the mechanism?

Senator PACKWOOD. I will come to the premise I am starting with. If we do nothing, the certainty is apparently that there will be a reorganization of the debt and the bondholders will eventually be paid. There is nothing uncertain about that.

Mr. SPINNER. The question is how long. If they ever want to dispose of their assets before that, they will obviously take substantial market losses, but I think most of the people in the marketplace—who knows—but the feeling in the street is that most of the repercussions of the New York City default have already been discounted in today's market.

Mr. ABRAMS. I disagree on the basis of this: I have heard mentioned of the sale of bonds that have taken place in the last few days. Government bonds and loans have risen in price.

The second thing is this: That the effect on a triple A credit, relating it to New York City's problems is not a favorable comparison. Relate it to a city not so prosperous as the State of Maryland. Take Scranton, Pa. I am not saying it is in trouble, but you have these lesser credits. They are very much influenced by the lessening of the New York City bond market because these are in the credits of the B double A, skimpy A, as they call it.

In the triple A credit they are not affected.

Senator PACKWOOD. They are not in trouble?

Mr. ABRAMS. They are not in trouble and will not be affected. There are the marginal cities that have trouble.

Senator PACKWOOD. Isn't this true whether or not New York City is sound or unsound?

Mr. ABRAMS. The question is, it is a fact that New York City is on the brink of disaster, will it affect other credits and the salability of bonds?

I say, in summation, it will be disastrous to them. It is the lower rated municipalities that just don't have the economics to support a triple A rating or double A.

Senator PACKWOOD. Is your answer if New York goes under, it will cause certain tremors, and bond buyers will be more discriminating in the bonds they buy?

Mr. ABRAMS. That is correct.

Senator PACKWOOD. I have no further questions.

The CHAIRMAN. Senator Cranston.

Senator CRANSTON. I join the chairman in noting that while you all, in your testimony urged us to do whatever we are going to do, swiftly, much of what has been proposed, including a reorganization of the Bankruptcy Act, this committee cannot do at all, and the Congress would not do swiftly. I recognize that probably none of you have had a chance to read thoroughly or study the option No. 1 that the committee gave some consideration to. I assume that in part, because of the time frame you have been operating in and partly because your testimony didn't seem to take account of certain things that are in that proposal. For example, a requirement that there is participation by private investors in purchasing bonds that would replace the Federal involvement in 6 years.

Second, removal of the tax exemption from New York's bonds or, alternatively, a 3-percent fee to be earned by the U.S. Treasury in guaranteeing the bonds.

Finally, the requirement that New York move at once to a balanced budget.

There are also a number of safeguards I am not certain you have taken into account.

Mr. ABOUD. May I respond to that?

The CHAIRMAN. Yes.

Mr. ABOUD. Senator, let me first suggest on the merit of swiftness, although we would all agree, I don't think we would all agree that it is better to do something if you can do it more quickly than to do the right thing, if it is going to take a little longer. I suspect also that there may be some hesitation on the part of the Congress, even to go the route of the direct guarantee.

I am not in a position to judge that. On the proposal, as I understand it, there is no structure. It would require that the investors come up and put up an additional \$1 billion of debt. On what basis would they come in? Would they come in as senior creditors? The proposal raises more questions than it really answers, it seems to me. Would they get a new type of security? Would it have to be marketable or would they take it as an inducement to bring the Federal Government in?

Senator CRANSTON. It would have to be undertaken by New York City. The Federal participation would be contingent on the matching participation by private investors.

Mr. ABOUD. On what basis would you lend to the State? Would you lend to the State on basis senior to the other obligations of the State?

Senator CRANSTON. We do not lend to the State. We would guarantee bonds issued by the State.

Mr. ABOUD. What happens if they can't pay the obligation?

Senator CRANSTON. The Emergency Loan Guarantee Board would supervise the debt, hopefully preventing a failure to repay. Finally, revenue-sharing payments would serve as collateral.

Mr. ABOUD. Revenue sharing of the city of New York?

Senator STEVENSON. At that point we wouldn't be taking revenue sharing, we would be pouring it into the city or the State.

Mr. ABBOD. Senator, I must say that I don't think that the direction in which the legislation is going differs very much from the objective I have tried to outline here. We are both trying to go in very much the same direction. I'm merely trying to point out as a technician and market participant that a view from the marketplace, from the foxholes, if you will, would suggest to me that I would have more uncertainty about something like this and intend to keep hands off than I would be something that would have the certainty of a regular procedural reorganization.

Senator CRANSTON. How do you get voluntary exchanges?

Mr. ABBOD. First, it is a voluntary organization. Once you go in you set up the board of trustees. The board of trustees then determines what the exchange will be. When there is concurrence—

Senator CRANSTON. Is that a bankruptcy default procedure?

Mr. ABBOD. I would not classify reorganization with bankruptcy. If we did classify bankruptcy, and one of the dangers of these kinds of hearings is that for simplification purposes we tend to minimize the small differences. And the reason I am sensitive about this is many, many corporate clients and many, many individuals have reorganizations and restructures, and I would hate to have them think they were going through a bankruptcy procedure, because it would then inhibit them.

Senator CRANSTON. Who would arrange the reorganization?

Mr. ABBOD. The board of trustees set up under the statute.

Senator CRANSTON. Who appoints them?

Mr. ABBOD. I have suggested there be two from the bondholders which could be appointed by the trustees of the various bond issues under a vote. One from the city, who would be appointed by the mayor and one by the State, appointed by the Governor and two from the municipal workers, appointed by the unions.

There is nothing magic in that structure. That came to mind only.

Senator CRANSTON. The idea of a guarantee with the restrictions on it is to buy time to deal with the problem in an orderly fashion.

I trust we do share the same basic objectives. And there is no desire to do it swiftly just to get it done. The desire is to do it properly.

Mr. ABBOD. Senator, I would hope that the fundamental difference of a direct loan and guarantee would not be lost in the exchange of conversations here.

Senator CRANSTON. I'm well aware of that.

The CHAIRMAN. Senator Garn.

Senator GARN. I have no questions, Mr. Chairman. I would like to thank the witnesses for their testimony. Through the days of hearings it has been overloaded to one side. I appreciate hearing the other, and in trying to make determination about the facts you have come with specific alternatives.

The CHAIRMAN. Senator Biden. I beg your pardon.

Senator STEVENSON. I don't blame you at all.

The CHAIRMAN. Senator Stevenson.

Senator STEVENSON. I don't have questions either. I want to thank our witnesses for coming on very short notice, and in most cases a great distance, to give us the most refreshing testimony I have heard in these hearings. With some variations, it is basically the same. It supports the restructuring of the debt of the city of New York. The

problem we all have is how to get from here to there. The problem is complicated by semantics.

Nobody likes that word bankruptcy. I have observed that today. And nobody much likes a procedure that implies bankruptcy. The only procedure I know of that is available at the moment, outside of the procedure under New York statutes, which I am told is of doubtful constitutionality, is the chapter 9 procedure which, with some amendments, might not accomplish all that you, Mr. Abboud, want to do, but might with some fairly simple amendment, and pending the major kind of long-term reorganization of the Bankruptcy Act, be used to take care of this pressing situation.

Mr. Abrams, you have all talked about a voluntary reorganization, and I do not quite know what that means. Based on the testimony of the comptrollers, the city of New York could voluntarily file a petition tomorrow under chapter 9.

It doesn't have to wait for a default to occur. I guess my question is would that be an acceptable procedure? Could we avoid default and begin this process of voluntary reorganization by perhaps conditioning Federal assistance or a voluntary reorganization if that is what is necessary to encourage the city to do this. Is that an acceptable way of doing what everybody wants to do, but in a voluntary way. And, if not, how do you get there before it defaults, which is in December?

Mr. ABRAMS. My plan takes no legislation whatsoever. It is simply a plan that the holders of the outstanding notes, which is the pressing money required, which, as I said, is \$2.8 billion, would be asked to exchange their bonds for a coupon rate suggested at 9 percent due in 10 years, with a sinking fund that begins in 5 years.

I have in my opinion that you wouldn't get in every single bond, but you would get in such a tremendous percentage of them, that you would alleviate that pressing amount of money.

The second thing that is required, however, is as we heard in the testimony earlier, the requirement of cash flow for operating deficits in this present fiscal year. I have been figuring, and I know you were doing a lot of figuring, and everybody else was doing a lot of figuring, that it came to \$1.2 billion.

Senator STEVENSON. Exclusive of the debt service?

Mr. ABRAMS. Right. I disagree with some of my friends about the heavy indebtedness of the city of New York. I disagree that you have to raise this and lower that. The city is proceeding down a path of righteousness. I believe it will get there. If it weren't for the RAN notes, bond participation notes and tax participation notes that are coming due within 6 months, that they would make it, but we do need that \$1.2 billion. Banks have been bailed out and that is a historic record. Why not for the welfare and the help and the security of 8 million people against 8,000 depositors, why doesn't the Federal Reserve step in and say, "We will take \$1.2 billion 8 percent bonds due in 15 years?" I think the Federal Reserve bank might have a credit that could make a profit on them and not just a payout.

Senator STEVENSON. What you are suggesting, if I understand it correctly, is that the best way the Congress could help the city of New York is to do nothing, except to whatever extent is necessary, encourage the Federal Reserve Board to do something.

Mr. SPINNER. I have one other question; if they can't balance their budget now, how will they pay 9 percent? That will cost another quarter of a billion dollars a year. Where will they find this money?

Senator STEVENSON. Federal Reserve Board, I guess.

Mr. ABRAMS. That is not so. Mr. Goldin gave good testimony along those lines. He says that you will not be able to balance the budget in the next 6 months. Over the next 2 to 3 years, you will have a balanced budget. By law and by the emergency committee, and I agree with Mr. Levitt that it is well done. This should be enough to make this a good credit, in my opinion. I feel that New York City isn't that bad off. I have seen banks, and believe me, many of them lend a lot to utilities far beyond what they should have lent them in 1-year notes, and they had to go back and roll them over and roll them over until they got a market where they could sell their bonds. This is not an unusual thing. It is voluntary on the bank. This is what I am asking for the city of New York to attempt to do. It does require Congress maybe to prevail on the Federal Reserve bank.

Mr. ABBOD. Senator, I would like to approach the question from a different aspect. You say, couldn't they go in under chapter 9. The specific provisions of chapter 9 required that 51 percent of the creditors agree to the plan before you can define it. The difficulty of the situation such as this is you can't find the creditors. To get them to agree to a plan is difficult.

Senator STEVENSON. I was assuming with my reference to simple amendments that we would eliminate—the House is moving ahead with this—eliminate the 51-percent requirement and the two-thirds requirement.

Mr. ABBOD. That would be constructive. If you went through chapter 9 and provide for two situations, one where you are really in bankruptcy and in a liquidating posture, and I think that is different from a situation where somebody has become overweight and has to lose that weight to get into an acceptable trim, and that is the position we have in New York. We don't have a former. There is a real difference between bankruptcy where you are liquidating and getting back to the tag end, and one where you have a viable going corpus and it happens to have taken on more weight. I hope there would be a separate sections that would draw that distinction and thereby eliminate the stigma.

Senator STEVENSON. Mr. Abboud, you recognize the operating deficit problem. How is that taken care of under your proposal?

Mr. ABBOD. Under the proposal here, of course, you would relieve the deficit considerably.

I started out by saying if the figures of the Wall Street Journal are accurate, debt service requirements are running about \$2 billion a year.

Those would be eliminated. They would be suspended. Therefore, you would relieve the cash requirement in the short term. There would be other requirements.

My distinguished friends from New York in the banking business tell me in the short run, there are considerable requirements.

I propose to take care of that by direct loans in the nature of trustee certificates which would have to be repaid before there can be

any service on the other debt which would create an incentive to pay that off.

Senator STEVENSON. Would they be purchased by the Federal Reserve Board?

Mr. ABBOUD. They would have to be purchased by some agency of the Government. We ought to be careful that we don't use the Federal Reserve for anything other than monetary policy.

Senator STEVENSON. Would those trustees' certificates be marketable?

Mr. ABBOUD. Those trustee certificates in the hands of the Government would be—

Senator STEVENSON. Marketable in the private market.

Mr. ABBOUD. The Federal Government would be advancing money and getting trustee certificates.

Senator STEVENSON. I am wondering if, with the burden of the debt service suspended, the trustees could issue certificates that would have a priority on the resources of the State and whether those certificates would be marketable.

Mr. ABBOUD. That could well be the case.

In effect, what they would have would be a large capital base by subordinating all of the other capital debt. This would be comparable to that. I would think that would be a second stage of operation in the first instance.

Right now, people just are not going to hold any more New York obligations if they can avoid them.

Senator STEVENSON. Thank you, Mr. Chairman.

Senator PROXMIRE. Senator Biden.

Senator BIDEN. Mr. Abboud, if I understand—and I am not sure I did—if I caught the beginning of your statement, I thought the basic premise on which you were operating was that you are saying it is unrealistic to expect New York to make it even if we proceed the way which was suggested here in the committee for a limited—to guarantee for a limited duration these bonds; is that correct?

Mr. ABBOUD. I don't intend to convey that impression, Senator. I said the debt in total is too large, and cannot be properly serviced by the present revenue base.

The maturity of the debt is too short, requiring too much rollover, and the debt service requirements including interest are too heavy and absorbing too much cash.

I am suggesting we have to take this burden of short-term debt, extend it, and reduce the interest rate on it.

Senator BIDEN. That answers my question.

Mr. ABRAMS, in your proposal again, if I understand it—and I didn't understand Mr. Abboud's, so maybe I didn't understand yours, either—is there any prohibition in the law that would prevent your proposal from taking effect.

I thought you had to have—your proposal does not require us to go the chapter 9 route, does it?

Mr. ABRAMS. No, it does not.

There could be brinkmanship involved there, I might say.

Senator BIDEN. All right. You have answered my question.

Mr. Spinner, you said something that no one else has raised.

Would it be better to make an outright grant?

Mr. SPINNER. I don't recommend that at all.

Senator BIDEN. I know you don't, but between the option of going the route of guaranteeing, which has been suggested here, and just an outright grant?

Mr. SPINNER. My position is you might as well do it, because that is what it really amounts to.

There ain't no way they will balance their budget and get their house in fiscal order if you bail them out. The incentive is gone. The pressure is gone.

I might add one other thing. I know there was some question about bankers coming here to testify on this side of the fence. I can name a lot of people in the Midwest, Southwest, South, and Far West. I don't think the position I have put forward here today is a minority position at all outside of New York City or outside the State of New York.

Senator BIDEN. I have no further questions.

Senator PROXMIRE. Senator Javits.

Senator JAVITS. Mr. Abboud, I ask you this question.

Do you know how much New York City has sent to the Federal Government in taxes and how much it gets back?

Mr. ABBOUD. I have heard it is many times greater than what it gets back.

Senator JAVITS. Do you know it in money?

Mr. ABBOUD. I do not recall it.

Senator JAVITS. Do you know if my figure is correct? A good estimate is \$15½ billion from New York City and the city gets back all kinds of transfer payments, and everything else, \$3½ billion.

Mr. ABBOUD. I would have no reason not to accept that and would certainly accept it if you told me that was right.

Senator JAVITS. Do you think with the scheme you have described and with its troubles and difficulties, do you think New York could survive to be remotely what it is under that plan, even if there were a legal way to do it?

Mr. ABBOUD. I do. I have faith in New York. It is a vital city. They have themselves in a situation that many of us could have easily got ourselves into in becoming overextended.

I don't think this is cause for great stigma or great embarrassment. I think it is cause for restructuring.

Senator JAVITS. Mr. Abboud, we are not stigmatized or embarrassed. We have been here and spilled our guts out over every committee table. We don't feel that way at all.

Suppose you are wrong. You are one man and it is your opinion. Suppose you are wrong and the forecast of the New York officials and other witnesses are true that the town is in chaos and begins to go very fast.

What do you think that would do to our country?

Mr. ABBOUD. Senator, if you are saying what would happen if those that predict that the city is going to erode away and therefore the rest of the country is perforce going to erode away, too—

Senator JAVITS. I didn't say that. I asked you.

If New York City is really very seriously hurt and a lot of it becomes boarded up like other cities have—new Washington, D.C., and many others—what effect will that have on the country?

MR. ABBOD. Senator, I am sorry, but I cannot accept that New York will become boarded up. If we followthrough a program like this it is asking the bondholders to stay with it and have faith. It is not diminishing the flow of funds to the city.

I think the city would become more vital.

Senator JAVITS. In any case, you don't want to face the answer to that question.

MR. ABBOD. I don't accept the assumption that there is a remote possibility that New York City would be a boarded up city.

Senator JAVITS. If your bank is in New York City, would you think that?

MR. ABBOD. Our bank is in New York City. We have a real estate office there, for example.

Senator JAVITS. Isn't it a fact—you said that quietly. Isn't it a fact that nobody will buy trustees' notes of New York now.

MR. ABBOD. I said that and stand by that, Senator.

As I replied to Senator Stevenson, I think it is a possibility in the second stage and not the first stage.

Senator JAVITS. Something must be done to bring New York City money or credit. Isn't that true?

MR. ABBOD. There is no disagreement with that.

The underlying assumptions on which my program is based is that something is done now in direct grants from the Federal Government, but senior to the other obligations.

I am not suggesting any delay.

Senator JAVITS. Your plan is entirely positioned on the legal instrument through which it can be accomplished.

MR. ABBOD. The plan is predicated on having legislation, whether amendatory to chapter 9 or new.

Senator JAVITS. Some sort of composition and solvency chapter 11 proceeding that is practical for a city must be installed.

MR. ABBOD. There is legislation that is installed that I feel is inadequate and would have to be corrected in chapter 9. It could be new legislation or refinement of that legislation.

Senator JAVITS. If we believe that cannot be accomplished by December 11 at all, doesn't that pull down your plan?

MR. ABBOD. Senator, it doesn't. What it would suggest would be you would have to make direct loans to the city under some kind of obligation.

Honestly, I have to say I shudder if you are going to make direct loans; I see the specter of Penn Central all over again where the other holders of obligations won't know where they stand relative to the obligation to the Federal Government.

Senator JAVITS. You say there is no choice if we don't have a legal instrument in place.

MR. ABBOD. If you don't have a legal instrument in place and the city is running out of money, you would have to make a direct advance and take a prior lien over anyone else until you get a legal instrument in place.

I would hate to think this Congress couldn't install such a legislation.

Senator JAVITS. I know. You don't want to think New York City would go down the drain. Other cities have and so have societies. We

don't like to face many things. Like Mr. Spinner said, we live through it. We lived through the depression of 1932, but what a toll it took, what it cost.

Mr. ABBOD. I have heard conversation here where people have said what they cannot do. It is like the scientist saying, "We can't go to the Moon from here."

I cannot believe with the creative and technical abilities of this country we cannot engineer a program out of this situation. I find it hard to accept that.

Senator JAVITS. I am only pointing out in respect to this committee, it has engineered a solution. That is option No. 1. They have engineered a solution in the absence of this law. That is why I asked the question.

Suppose we can't get the law. We have to consider their option and yours, which is interim loan.

Now, I would like to turn to Mr. Abrams.

I know your firm well, as you know, and it is a very intelligent banker's plan, but doesn't it require an underwriting by a syndicate which would make it tender for  $x$  percent of all the obligations? Make any tender you wish, but there will be a percentage that the syndicate has to underwrite?

How much time do you estimate it would take to make a tender and what percentage do you feel would have to be underwritten?

Mr. ABRAMS. Time is tough. I would put it this way, that the chances of doing this deal under this plan would hinge a great deal on the speed with which the commitment was made, I have suggested the Federal Reserve Bank. I didn't know the Government lent money to anybody. If that were to take place in a week or 10 days and the noteholders were going to be pressing their cash on December 11, I believe they would readily accept a new security in lieu of cash.

I don't think we would have to have a real syndicated underwriting stopgap.

Senator JAVITS. Suppose they didn't, Mr. Abrams. Wouldn't that bring on the same chaos we were told about when you were here by the loyalists, in view of the state of the law?

Mr. ABRAMS. I do believe—

Senator JAVITS. If we went that route and the bridge fell 1 yard short, wouldn't we be in trouble?

Mr. ABRAMS. I do think the time element is enough and I do think it will work. I do believe there is a day of grace. I believe this whole plan could be consummated within that period of time.

Senator JAVITS. Wouldn't you, if you were the Governor of the city of New York, pay anybody a preference who didn't take the deed?

Mr. ABRAMS. It may be forced to that depending on the judgment to be used, if it was an insignificant amount—

Senator JAVITS. Do you know how many holders there are?

Mr. ABRAMS. No.

Senator JAVITS. I would like to ask Mr. Spinner one question. What legal way did the State of Arkansas use way back in the 1930's? What did it do about those that didn't turn in their bond? How did it handle it legally?

Mr. SPINNER. They had no choice. They took that or got nothing.

Senator JAVITS. I would challenge that sharply and I will check the whole thing out. That they took that or got nothing.

Mr. SPINNER. They took it because that was the only alternative. They had paid everybody off.

Senator JAVITS. Well, what legal procedure did they have to use in that case? Any State law, Federal law, anything that you know of?

Mr. SPINNER. I would have to check it out.

I might add one other thing, Senator. You talked about civilization and I want to add that every major country throughout the history of the world that went down the drain went with fiscal irresponsibility.

Senator JAVITS. It did what?

Mr. SPINNER. It peaked out and went downhill because of fiscal irresponsibility.

Senator JAVITS. That is right. Absolutely right. Not solely because of that. Often they were attacked and undermined by outer forces, but fiscal irresponsibility had a lot to do with it. Those that feel like I do, feel it would be the heat, the fiscal irresponsibility, if through no course, New York's credit would be saved.

Mr. SPINNER. I disagree with that.

Senator JAVITS. OK. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Abboud, I want to make sure I understand what you are offering because you are an extraordinary man. You seem to somehow shy away from the notion of calling this bankruptcy. But you would suspend payment of principle and interest and yet it is not bankruptcy.

Mr. ABBOUD. Senator, there are two parts to that. First, I shy away from the word "bankruptcy" because it seems implicit in a bankrupt situation is a liquidating position where the corpus itself is a dead body and not vital and cannot be sustained.

I do not see the situation here.

The CHAIRMAN. It is never the case when a municipality is at stake. Nevertheless, don't you think it would be widely construed by the general public, including the investing public, as the same thing by another name?

Mr. ABBOUD. I think it would be widely construed as that. I think we have an education process. I don't think the sophisticated investors that intend to buy the securities would construe it as that unless we made it that. In the second part of the question where you say you would retard the—forgot what it was you would not pay principle and interest.

The CHAIRMAN. That's right.

Mr. ABBOUD. That is not quite true. If we go through the reorganization, the only period of suspension would be during that period where you are working out the reorganized plan.

The CHAIRMAN. Nevertheless, it is suspended.

Mr. ABBOUD. But it is payable at the end.

The CHAIRMAN. I'm talking about the tough problem presented to us by Mr. Millstein who pointed out that once you go this path, that that is default.

Therefore, a number of years, you cannot sell your obligation in many States through banks; many fiduciaries cannot buy it for their trust accounts.

New York would be legally out of the act. It seems to me from a psychological standpoint, having defaulted, they would be cut out of the market for years to come.

Mr. ABBOD. Senator, I would disagree with that. I would think if you had a new security, particularly one buttressed up and buoyed by a credit on the coupon that that would become an attractive instrument. In many companies where we restructure the debt and they are closed out of the commercial paper market once they are put back into an operating position where they are earning money, they go back into the commercial paper market, back into the bond market, back into the bank market.

It has not been our experience that reorganized and restructured credits are closed out.

The CHAIRMAN. It took Detroit 8 years. There has been no comparable event. This would be known by everybody throughout the country. It would be the kind of conspicuous development that everybody would remember during their lifetime. When a business goes through this, it is something else. It is hardly something that can't be handled.

It is not comparable to the fact that New York has gone into default.

Mr. ABBOD. It would be a mistake to compare Detroit to New York or another regional market. The debt of the regional communities tends to be small enough so that it can be absorbed in the local communities. You can always sell these cities in the regional market.

New York City is an international city. It would have a market on an international basis. If creditors had confidence that it was in fact restructured and repaired, I would not agree with the premise that it would take a long time for it to get back into the marketplace.

The CHAIRMAN. What you are offering, you and others have talked about the fact you shouldn't reward people, bondholders and note-holders who have invested in New York. We shouldn't have a situation where they would be rewarded, bailed out, and paid off.

Yet you are offering a note—issuing the present note—and bondholders' conversion into a long-term debt carrying high and guaranteed yields and with a tax writeoff—isn't that rewarding the very watchdogs who failed to watch what was happening?

Mr. ABBOD. I would like to correct a misunderstanding here. I don't think I used the words "rewarding the bondholders." I do not think anybody who buys a piece of paper under a contractual obligation ought not to get precisely what that contractual obligation is. I do not have any inhibition about paying them in full, if that is humanly possible.

As a matter of fact, I'm a little bit—I find it very awkward and a very unhappy state of affairs that they cannot get what they thought they were buying.

As a banker, I have to represent these people and do so with great enthusiasm. The situation here is there isn't enough money to pay or sustain it. By necessity, just as in our workout situations, we have to reduce the amount of debt.

Under my plan, the interest rate would be cut. The maturity would be extended. In return for increases in taxes and cuts in costs they may have to surrender some of the principle.

I don't say that with any relish or happiness at all. I wish it weren't true.

The CHAIRMAN. How would they get the additional billion dollars they need to meet their operating deficit?

Mr. ABOUD. That is where the Government loan comes in under the trustee certificates. The cash shortfall is a temporary nature. If they go through the program they are talking about, they will be in a balanced position, and by 1978 they will be in a positive cash flow.

If that is the case, the Federal debt can be repaid and they can begin to pay on the others.

The CHAIRMAN. If we follow your course, you would have a situation where New York would have great difficulty getting back into the market. You have a situation where they suffer default. You have a situation where the Federal Government would have to come in, anyway, with a kind of bailout, a loan for an indefinite time, at least until they get back into the market.

I would expect them to balance their current operations budget but to be able to take care of their capital investment for the next 10 years without a Government loan once they default is unrealistic.

Mr. ABOUD. I've tried—I do not accept the premise that it would take New York, under the conditions we have postulated, a long time to get into the market. I would think, first of all, if they are going to balance the budget, they will not have to increase the debt and we have frozen the existing debt for the time being.

The cash shortfall would be accommodated by direct grants from the Government. As soon as the cash flow permitted a repayment of the Government loan, the market would be hungry for New York obligations, particularly if they took it in the form of trustee certificates.

The CHAIRMAN. Let me ask Mr. Spinner. I want to be sure I understand. Are you advocating the Federal Government do nothing?

Mr. SPINNER. That's correct.

The CHAIRMAN. Take no action at all?

Mr. SPINNER. That's right.

The CHAIRMAN. They not only have the problem of meeting their securities that come due, they also have a very sharp deficit in their operating budget.

What do they do about that?

Mr. SPINNER. That is the problem they will have to work out with the employees.

The CHAIRMAN. They have reduced their employment by 30,000. They have already got their schools operating on a short week. They have every child in a maximum size class. They have a wage freeze for 3 years. What do they do? Lay off the policemen and firemen?

Mr. SPINNER. They have closed the barn door after everything is ridiculous. The pay scales are ridiculous. They have a pension plan that no one else in the United States has one like it.

The bullet has to be bitten by everybody.

The CHAIRMAN. You feel you are rewarding New York if we follow what seems to me and some others to be a pretty spartan, tough proposition?

They have to balance their budget over 3 years. The option they are considering holds them on a short leash. The guaranty is for 1 year. If they don't make progress, it is cut off. It is administered by Mr. Simon together with Arthur Burns and John Dunlop. The State has to raise taxes to cover half the deficit. It is a tough, hard course.

Mr. SPINNER. First of all——

The CHAIRMAN. It is an orderly course. We have some idea where it is going. I would have more confidence under the circumstances that we will meet the essential services. New York will be able to get off the Federal Government's back because it will have access to the market. Under your proposal they would be out in the cold.

How do they get back?

Mr. SPINNER. First, they don't pay any interest or principal that matures. That is \$2 billion there. That covers the cash flow problems.

The CHAIRMAN. It doesn't. We are asking for more information but all of the evidence we have by the witnesses that appeared today and the day before is that there is no way this covers the cash flow problem.

We may have been misinformed, but the information we have is that they are short on the cash flow by \$1 billion.

Mr. SPINNER. I thought they had a budget deficit of \$1.2 billion.

Senator STEVENSON. That is exclusive of the debt service.

Mr. SPINNER. That assumes the debt service is suspended also.

The CHAIRMAN. You are overlooking, it seems to me, the intrayear problem. It does not matter because they have a deficit during the year that that deficit can be figured to be the same dimension each month. It is very severe in December and January. Under those circumstances there is no market they can go to.

Mr. SPINNER. They would have to devise some system. The fact remains I contend unless it gets this tough there will be no realistic adjustment of salaries of the people that are working.

If you compare the number of people working for the city of New York per population, it is still way up.

The CHAIRMAN. We have that there and it is not out of line.

There is a study made by the Congressional Budget Office and New York is in line with other cities.

It could be less, and they will cut it down, but it is right in line with other cities.

Mr. SPINNER. I have seen different statistics.

The CHAIRMAN. Their capital expenditures on common functions is fourth. It is not as low as Chicago, but it is lower than San Francisco. It is lower than St. Louis. It is lower than other similar cities.

We are going to require them to cut that further. They will be near the bottom under our plan.

Mr. SPINNER. Again I state the fact you have to take a tough position because it is a serious problem that has been allowed to go on for 10 years.

The CHAIRMAN. Have you read the financial plan that the city of New York submitted to the State control board?

Mr. SPINNER. I have not.

The CHAIRMAN. You might be enlightened by that. I think it made real progress.

Mr. Abrahms, I want to make sure I understand what you suggest. It is fresh and new and it may be something the committee would want to seriously consider.

As I understand it, MAC has been trying to do what you suggest. MAC has not had what you suggest, which is a loan from the Federal Reserve of 1.4.

Mr. ABRAHMS. 1.2, whatever the deficit is of the next fiscal year.

The CHAIRMAN. How long can we be so sure in view of the widely publicized difficulties that New York has that they will get this kind of agreement, even with the 9 percent rate?

Mr. ABRAHMS. I have the feeling that the notes coming due in the marketplace, bonds coming due starting October 11 and January 1 of 1976, and so on—they are in the MAC prospectus if you want to read them—I just have this feeling that these people that hold these notes would readily exchange them for a 10-year security with a reasonable coupon somewhere between the high and low of what the notes are outstanding, that they would come in at such volume that there would be very little to contend with.

It may have to be underwritten. When you take the fact that these notes today on a cliff-hanging situation are quoted on the January notes as 80 to 85, then I think the new bond—and I am saying this conservatively—would be worth in the market 90.

Now, that is a very good incentive if you are just going to stay with the notes that will float around with no sizable market.

This is my own personal feeling. I feel strongly about it. On this basis I feel that this plan will succeed.

Now, there is no question about it, that you could threaten the holders of these notes with chapter 9.

I don't know what the addition to that legislation has to be.

As I have gone through it many times in Florida, it was 50 percent consent of the bondholders plus one bond. And not 51 percent I don't think. This was accomplished in many cities. West Palm Beach, Coral Gables, St. Petersburg, Miami, a number of cities.

I believe in the Arkansas case that is how they forced the hand of the bondholders.

With that hanging over the noteholder and his ability to see a good bond and I said here I proposed a sinking bond. If all of what the people of New York said would take place in the next 3 years by the 5th year the balanced budget would make it possible for them to retire the bonds in the 10th year.

This is a strong security.

The CHAIRMAN. I have a question that Senator McIntyre requested I ask Mr. Abboud.

In your judgment, what would be the cost to the Federal Government of adopting a program of preventing default of the kind you suggested here and the cost of the program of permitting default—

Mr. ABBOUD. I don't understand.

The CHAIRMAN. We have been discussing an operation with a \$6 billion guaranty to prevent default, participation by the private sector and so forth.

What would be the comparative costs?

Mr. ABBOUD. If I may approach the question in a different manner in that I don't think the cost to the Federal Government of doing the way I propose, that the over the long run would be anything because the direct grant would be at a Treasury bill rate and all you are providing is a mechanism for the community to help itself.

Now, under the guaranty program, I think the cost—I don't think you are able to calculate it.

My own judgment is there would be tremendous disruption in the marketplace.

The CHAIRMAN. On the one hand I'm talking about a guarantee. I agree that all these things are speculative. We are confident the guarantee won't be called. We have a taxable instrument that we will have to pay \$1 billion premium, \$25 billion, et cetera. That would be \$210 million a year income to the Federal Government. You are talking about a grant.

Mr. ABBOUD. No; I'm not, Senator. I'm saying there should be a direct loan to the city and that loan would carry an interest rate which would be equivalent to the 90-day bill rate. Since the Federal Government would raise the money in the 90-day bill market, it would be a wash.

The CHAIRMAN. How much of a loan would it be under your plan?

Mr. ABBOUD. The amount of cash shortfall which I understand is in the range of \$1.2 billion.

The CHAIRMAN. How about the capital needs for the next 8 years?

Mr. ABBOUD. The capital needs can be accommodated by a deferral of the payment of the principle and reduction of the interest rate on the existing indebtedness.

The CHAIRMAN. How do they get back in the market?

Mr. ABBOUD. When their revenues exceed their expenses and they have repaid the Federal Government.

The CHAIRMAN. When they are deferring payments of principle and interest during the 8 years or so they are making the capital investment out of the deferred payments.

Mr. ABBOUD. If you take the debt that matures in the short term and extend the maturity so you don't have to repay principle except out over a period of time, and if the principal costs go down because you have reduced the interest rate, your cash flow coming in is very much enlarged.

The CHAIRMAN. You are not talking about calling down on principal?

Mr. ABBOUD. Yes; I'm saying it may be necessary. I say it with great sadness. I think everybody should get back 100 cents on the dollar when he buys an obligation. If it is necessary to distribute the burden to the constituencies, then they will have to take reduction in the principal in return for the municipal employees taking reduction in their pay in return for which the taxpayers pay the higher tax in their community.

The CHAIRMAN. This is the problem that has bothered me. I think I have asked it enough to feel that I am not going to get an answer that would satisfy me. Maybe I'm wrong. Will the Federal Government have to loan \$1 billion a year for 8, 10, or 15 years?

Mr. ABBOUD. Good heavens, no. I would think—

The CHAIRMAN. What assurance can you give us?

Mr. ABBOUD. If the Federal Government, under the plan I proposed, has to lend \$1 billion a year for the next 8 or 10 years, then under the plan you propose, which is an additive debt to the existing debt, then by golly, that \$6 billion is gone and you are going to have to make those payments in the future, too.

Both of us are assuming that the budget is balanced and the revenues that come in are positive.

The CHAIRMAN. There are a number of differences. Difference one, we are told that the revenues of the city are sharply reduced once

they default. That is part of the—real estate surtax diminishes by 42 percent once they go that route. Were you aware of that?

Mr. ABBOUD. I was aware of that, Senator.

Senator STEVENSON. Don't be too aware of that. That is a debatable proposition.

Mr. ABBOUD. I was aware that is a consideration. I'm trying to avoid default. My program constitutes reorganization.

The CHAIRMAN. You think the courts would accept this as not being default when you don't pay interest on time and you don't redeem the obligations of your security holders?

Mr. ABBOUD. We do it every day with borrowing customers. When they say I have myself into a debt situation that is too short and the interest rate is too high, we extend it and we reduce the interest rate. I consider it proper banking.

The CHAIRMAN. How many investors do you have with \$14 billion of liabilities?

Mr. ABBOUD. We have countries around the world that have more than that.

Mr. SPINNER. I can think of one, the Federal Government.

Mr. ABBOUD. I would like to make this point because I think it really is germane to the reason for stressing this kind of mechanism to be adopted. There are many communities throughout the country that could profitably use the mechanism for revenue obligations, for general obligations, for all sorts of purposes.

I'm not suggesting something which in my own opinion would be limited as a remedy for the New York situation. I'm suggesting something which I think is a void and vacancy in our general legal structure and because of that void and vacancy, it ought to be filled because lots of people can profitably use it.

The CHAIRMAN. All right, sir. I have taken too much time.

My problem with your proposal was very well dramatized by Senator Javits' question, when he pointed out it does seem we have an undetermined road outside of the control of the members of this committee as to how long the Senate would take with a change in the bankruptcy statute. They may be able to act in a few weeks, but they may not be able to.

This committee has some capacity, to act with respect to our program. The House has been making progress. They know they are under the whip. They have to come up with similar legislation in a week or so.

We are told by a man who works closely with the Judiciary Committee, Mr. Millstein, that there is no indication of any further progress in the House on the revision of the bankruptcy statute, on which your program hinges.

We are also told by Mr. Burns, who testified just today, that a quick decision by the Congress to assist or not assist New York is now urgently needed. Mr. Spinner properly echoed those words. All of us want a decision properly. To go the route of a new revision of the bankruptcy statutes seems to me to be taking a big risk for our country as well as for New York.

Senator Stevenson?

Senator STEVENSON. Gentlemen, you have been up against two of the most forceful and skillful advocates in the Congress. And they have

skillfully, as have others, focused the discussion on the dangers of restructuring New York debt under various proposals.

This discussion has focused little attention on the dangers of a \$5 billion loan guarantee. The restructure of debt is a normal customary businesslike procedure, which has been resorted to in the case of other failing insolvent, or whatever you want to call it, municipalities.

Every one of those options has its risks. Each requires instruments, new procedures, and time. One of the undeniable risks associated with the \$5 billion guarantee proposal is that it, above all others, takes time and may go nowhere.

Even if it prevails in the Congress, if we can accept at face value the statements of the President, it will not become law. That much is obvious.

What is not obvious, I think, to this committee and to the country are the other dangers of the \$5 billion guarantee route. You, I think, are uniquely qualified to express some opinion about the effect of that option on investor confidence at a time when public confidence, on the whole, in government and the fiscal responsibility of government is not high as well as on the marketability of the obligations of other units of government, other municipalities.

Finally, on New York itself. Does \$5 billion hold out any hope of saving the city of New York, of getting New York back on its feet, of getting it back into the market?

Would you gentlemen, for nearly the first time, express professional opinions about the consequences of that option, the \$5 billion guarantee option, and also if you would, not only the consequences for New York and other municipalities, but for the credit of the United States?

Mr. ABBOTT. My personal opinion is, I think adding another \$5 billion or \$6 billion to the debt of New York, which I think is too heavy now, would be a discouraging factor. It would lead me to take an adverse view of the future creditworthiness aspect of the community.

The addition of that burden to the Federal Government, which I would not believe would be repaid in any near-term type of situation, for the reasons that Senator Proxmire has brought out, that would be an added burden.

I think, worse than that, it would set a precedent, and you would have to apply it to other communities. This would be a discouraging factor in the U.S. Government securities market and with raised inflationary expectations throughout the country. It would be interpreted by the country as a device where the printing presses would be opened up and running.

That is my personal opinion. I am sure others have a different opinion.

Mr. SPINNER. I would say if the Federal Government could bail them out with \$6 billion that are maturing, that won't change my position one iota to the future purchasing of New York City bonds as opposed to if they went into bankruptcy. I feel strongly that they would correct their real problems much quicker if they went the default route.

Within a shorter span of time they would be able, on their own, to go back into the market, but if you tell me I have to buy New York bonds on the hope and prayer that you gentlemen are going to compound one mistake with the second one, I don't like those odds. That is 50-50. I have never been able to figure out which way you are going, anyway. I would avoid the credit.

If they solve their problem on their own—what you should do, other credits have done, is stand up and take their beating and come back. That gives them respectability again and marketability in a shorter span of time. I don't know whether it will be 8 years, 4 years, or if it will ever be.

As a man who advises other people, I think most investors would feel much more comfortable with the route I am talking about. We talk about \$1.2 billion cash deficits. That is a 10 percent cut in the budget.

If the president of my bank said, we either cut the budget 10 percent or we will go out of business, I would figure out how to cut my budget 10 percent.

Mr. ABRAMS. I really feel that this is so difficult to explain.

I have read in the papers, and I think New York has taken tremendous steps forward in the last 2 weeks. New York City's credit may turn out to be better than Chicago's in a short period of time.

Mr. ABBOUD. Want to bet?

Mr. ABRAMS. Let me put it this way: Chicago has its own default route now: Skyway bonds.

Mr. SPINNER. That is revenue.

Mr. ABRAMS. It says "City of Chicago" on it.

Mr. SPINNER. That is because the Federal Government built a highway right next to it, which I might add was very intelligent.

Mr. ABRAMS. I feel, Senator, if my plan cannot be adopted or any plan that is going to not come to fruition, and the city will be going down the drain, I feel sad about it. I think Congress should act.

I could add a lot of things I feel about the city. I remember the taxpayers bearing the brunt of 2 percent RAA bonds all over the Midwest, for example. The Robt I. Kerr River and dams that cost \$1.8 billion. There is a lot of philosophy that goes on and on. I think it is time the Northeast got a little handout.

Senator STEVENSON. Thank you, Mr. Chairman.

Thank you, gentlemen.

Senator JAVITS. I had a letter I thought we would qualify and put into the record as to the effect on the municipal bond market.

I think we have all made our point.

The summary seems to me to be what you originally presented as your basic ideas.

S. Lebenthal & Co., an important dealer in municipals.

Mr. ABRAMS. They have been specifically very active in the New York City bond.

Senator JAVITS. I had a letter from them in which they described what would happen in the market.

The CHAIRMAN. Without objection, it will be placed in the record. [The letter follows:]

LEBENTHAL & Co., Inc.,  
New York, N.Y., October 21, 1975.

Senator JACOB K. JAVITS.  
Russell Senate Office Building,  
Washington, D.C.

DEAR SENATOR JAVITS: The question has been raised. Would a federal guaranty of a taxable New York State municipal assistance bond create a disruptive situation for the credit-worthy issuer of conventional tax-free bonds?

As it is now, the disruption in the tax-free municipal bond market comes from the prospect of default by the second largest borrower in our capital society, the possibility of collapse of the entire municipal market, and from tax-free interest

rates which are so high now that, rather than compensate the investor for his perception of risk, they confirm his worst suspicions and drive him away.

Dealing almost exclusively with individuals, as this firm does, I can reveal something about the numbers and mentality of the individual investor as that information bears on the federal guaranty question.

With the banks having other sources of tax-free income and the insurance companies not having been major buyers of municipal bonds in some time, the individual investor was becoming the hope of the bond market. Last year individuals (households) accounted for 56-58% of the net acquisitions of new municipal offerings . . . 95% in the first quarter of this year and 45% in the second quarter.

Interested as the individual is in maximizing return on his investments, when he comes around to Municipal Bonds safety is first and foremost. If he wants to speculate, he does it in the stock market, not in municipal bonds. Municipal Bonds are for the savings portion of his funds. He buys to hold to maturity, not to make profits on market turnarounds. He has no interest in the promise of 9, 10, 11% tax free currently available from non-guaranteed M.A.C. bonds or 20, 21 . . . 25% tax free from New York City that are in the market, if he believes there is a chance of not getting paid. And that is precisely what he dreads.

I believe that investor confidence has deteriorated so far that now nothing less than the imprimature of the federal government itself on a M.A.C. type bond could (1) avoid default, (2) restore investor confidence, and (3) restore the market for conventional tax exempt municipal bonds as a viable instrument for funding the capital needs of our cities and towns in this and other states.

In my opinion, it is not a question of whether there should be such a guaranteed instrument, but when and how much it should pay.

A fully guaranteed taxable bond at a rate somewhere between long term federal agency bonds, which today are paying approximately 8.45% taxable and long Aa utility bonds, which pay about 9.61%, need not raise interest rates for the healthy issuer of tax-free bonds. Quite the contrary. The guaranty would eliminate the default spectre and remove from the municipal bond market the terribly disruptive pull that astronomical tax-free rates exert on all municipal borrowing costs.

One need not rely on compassion for New York City and its bondholders to justify involvement by all the people of the United States in avoiding default by the city and bringing the temperature of the bond market down. It is economically inexpedient for the country to isolate itself from the New York City problem. I point out what has already happened to borrowing costs for all issuers:

The average municipal bond, according to the Bond Buyer's 20-Bond Index, is now yielding 7.29% tax free. A year ago that index was 6.48%. The chart below indicates the tax-free to taxable yield ratios then and now.

[In percent]

	Bond Buyer 20 bond index	Long treasuries		Long Federal Agencies		Moody's long Aa utilities		Moody's long Aa corporates	
		Rate	BBI as percent of—	Rate	BBI as percent of—	Rate	BBI as percent of—	Rate	BBI as percent of—
Mid-October 1974_	6.48	8.29	78	8.74	74	9.93	65	9.41	68
Mid-October 1975_	7.29	8.20	88	8.45	86	9.61	75	9.06	80

At tax free to taxable yield ratios (underlined figures above) of 80% our towns are not benefitting properly from the tax exempt feature of the municipal bond. In my opinion, the greatest threat to the conventional tax-free bond is the sort of yield ratio that now prevails in our market. Although the tax exemption of municipal bonds is founded on constitutional principle and not economic expediency, principle is none the weaker for strong roots in an economic argument.

At the present rates all but very few municipalities throughout the country must pay to borrow, all the people of the United States in their role as local tax

payers have a stake in bringing those interest rates down. And that would seem to me the desirable and natural consequence of a federal guarantee of the taxable municipal bond.

Sincerely,

JAMES A. LEBENTHAL,  
*Executive Vice President.*

Mr. SPINNER. If I sold New York City bonds to my customers, I am not sure I would be a disinterested person in what happens to the refinancing of New York City bonds.

That is just a comment.

The CHAIRMAN. Let me wrap it up this way. Mr. Spinner, you said, and I think there was agreement at least on the part of Mr. Abboud that Chicago should loan Mayor Daley to New York—how about getting Mayor Daley's advice? Mayor Daley feels we should act and help New York. He didn't even wait for Senator Percy to finish the question.

Senator STEVENSON. Mr. Chairman, I know Mayor Daley's thinking better than you do.

The CHAIRMAN. He testified.

Senator STEVENSON. I will not put words in the mayor's mouth.

Bob Abboud may have talked to him too recently.

The CHAIRMAN. Does Mayor Daley say one thing privately and another thing publicly?

Mr. ABBOD. The mayor is perfectly capable of speaking for himself. I am sure that if the Senator talked to him that he would make his views known.

I would like to take the chance to make one observation, Senator.

The CHAIRMAN. On that subject, won't Mr. Abboud agree when Mayor Daley testified before a congressional committee in Chicago and said he favored Federal assistance now to New York that any private statement about how he feels is not applicable?

Senator STEVENSON. Now I know what you are talking about. I was listening closely when Mayor Daley testified. He said no such thing.

The CHAIRMAN. I talked to Senator Humphrey about that.

Senator STEVENSON. That is not what has been suggested. Perhaps according to the New York Times it was.

I also know more about what he thinks on the basis of some further reflection and some more information. That was a very general question which had nothing to do with New York. It was a hearing of the Joint Economic Committee on the condition of the economy and Senator Percy was saying don't you think we should rely on private enterprise, and the mayor very angrily jumped in to defend the role of the Government, with particular reference to emergency unemployment.

There may have been a passing reference at some point in that testimony to New York. He was not testifying on that subject. He was not testifying in support of this bill.

The CHAIRMAN. Before we mark up the bill tomorrow we will try to secure a statement from Mayor Daley.

I am confident that it will be one that supports New York.

Senator STEVENSON. We are all supporting New York. The question is how.

The CHAIRMAN. We had mayors saying don't let New York default, The counties said, 56 to 8, don't let New York default.

Every official group we could find says on the record that we should follow some kind of route like a guaranty route.

Mr. ABBOD. Senator, may I—because I think in the conversation that has taken place there may be some misunderstandings—I would hate for my own position to be misunderstood by my colleagues or my peers or the community at large.

I hold great affection for the Northeast. I was born and grew up there. I think the mayor's position—and he can certainly speak for himself—and my own position is that I am very supportive, want to be very supportive of New York City.

I am very grieved by the problems they are going into.

There is no suggestion—I hope there has been no suggestion of any finger pointing because there but for the grace of God go any of us.

We would expect a reciprocation of that kind of support. It is a great city with great people. Mayor Beame is an extraordinary public official. All of those who have bent to the task of trying to repair the situation have put in extraordinary hours in a talented way.

I would not want anything I have said here to indicate in any way a lack of faith about the future of New York, either the city or the State.

The difference, I think, only lies in methods or means of achieving a common objective. That is the sole difference and it is that of a technocrat, technician, diagnostician.

I hope the committee would have taken my remarks that way.

The other thing, then, I would like to underscore, please, there is no suggestion in any way that I think anybody who bought a security with a stated amount of principal or interest to be paid should get anything except what was contractually committed to be paid to him.

I think he should. I think it is hurtful when they are not.

The only point on the issue here is whether or not in fact there is the money and whether they are better off to get a little bit less but the certainty of something less than to continue on this basis.

The CHAIRMAN. Your testimony has highlighted the difficult problem the committee will have tomorrow when we mark up the bill.

Here we have three witnesses all of whom reject one option the committee has been considering.

Two of you do with considerable emphasis.

When you come to offer your own proposals you reject each other's proposals.

We have to act. We have to come to some conclusion that we can get 7 members of the 13-member committee to agree on.

It will be extremely difficult because we simply don't have any kind of an alternative in this extraordinarily difficult situation on which we can secure agreement.

Your testimony here has been most helpful, particularly in highlighting the dilemma this committee faces.

Thank you very, very much. I appreciate your coming in under these circumstances and appearing so late.

The committee will stand recessed until 10 o'clock in the morning.

[Whereupon, at 8:30 p.m., the committee hearing was adjourned, to reconvene at 10 a.m., Friday, October 24, 1975.]