NEW YORK CITY

For release on delivery

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STATEMENT BY PAUL A. VOLCKER
PRESIDENT, FEDERAL RESERVE BANK OF NEW YORK
BEFORE
THE SUBCOMMITTEE ON ECONOMIC STABILIZATION
OF THE
U.S. HOUSE COMMITTEE ON BANKING, CURRENCY AND HOUSING
ON NATIONAL AND INTERNATIONAL IMPLICATIONS
OF A NEW YORK CITY DEFAULT
ON THURSDAY, OCTOBER 23, 1975

You have requested my comments on the national and international implications of a default by New York City, and I appreciate the opportunity to make some general observations on that problem. In doing so, I want to emphasize the City's problems cannot be considered in isolation from those of New York State and certain of its agencies. The possibilities of avoiding a default by the City, or should it occur, of containing the impact of a default, will depend among other things, on the prospects for the State itself, and its capacity to assist its agencies and the City.

I am sure the Committee is under no illusion that there can be a single, simple answer to the question of the implications of default.

We know, of course, the volume of City securities outstanding. We can identify some of the institutional holders of those securities. We can observe what has happened in the market for municipal securities and in other markets as the threat of default has mounted. We can estimate the

prospective short falls in cash flow if the City is unable to find financing, and the size of the expenditure cutbacks that would be necessary to restore budgetary balance. But those observations can't provide a complete picture.

We are not dealing just with measurable financial magnitudes but with the psychology of financial markets and the human reactions of workers and citizens to the prospect of a violent financial squeeze that would force immediate drastic curtailment of jobs and services. Perceptions of investors and judgments about the impact of a default on the financial system cannot be anticipated entirely on the basis of objective fact and rational analysis. Uncertainty and fear can feed upon themselves, and become the over-riding influence on events. The other side of the coin is that fear and uncertainty can be quickly dissipated when it can be convincingly demonstrated that there is general understanding of the nature and magnitude of the problem, that means are available to deal with it, and that there is a broad consensus on the need to act.

In evaluating the problem, I would like first to reiterate a few simple points that seem to be fundamental to any assessment of the situation. I will then touch upon some aspects of the present market situation and the implications for the future. Finally, I will outline the magnitude of the financial problems before the City, State, and State agencies as I see it.

Some Basic Points

1. An act of default--actual failure to meet debts or obligations when due--by an entity so large as New York City is bound to have great significance, both symbolically and because it would trigger other events. But at least some of the consequences are felt in advance of the formal act. Surely, default by the City, if it occurs, will have been one of the best advertised events in financial history. That possibility is already being discounted to some extent in the markets, as reflected most obviously in the current prices of City and some other municipal securities.

2. The effects of default by New York City would likely be greatly aggravated if it were followed, or accompanied by, default by State agencies or by a prolonged inability of the State itself to finance its needs. As matters now stand, we cannot be sure a State agency default will not actually precede default by the City.

3. The consequences of a City default would depend critically on the manner in which any such default is handled, and the measures taken to contain its impact. Should the relevant authorities be able to present promptly a fair and credible plan for rescheduling the debt, have an adequate legal basis for enforcing that plan, maintain interest payments at a reasonable level, and carry on essential services in a context of social stability, then major steps would have been taken to dissipate uncertainty and provide reassurance to the holders of New York securities. All these matters, in turn, will rest upon the ability of the City to formulate and finance an orderly, stringent program to restore its budgetary position. To the extent such plans are lacking, or are not credible, uncertainty will be exacerbated, with adverse consequences. The present efforts of the Emergency Financial Control Board in New York can help lay the basis for such plans.

4. The financial problems of New York City, and to a lesser extent of New York State, are in part an out-growth of long-term social and economic trends, some of which have been aggravated by

the recession and by already exceptionally high levels of taxation. Planning to restore the financial position of the City, in or out of default, must recognize the importance of sustaining the economic base of the City over the longer run.

5. While the New York City problems could have national and, indeed, international consequences, the relevant question is one of degree. Whether these effects become pronounced and lasting obviously depends upon the skill exhibited in preventing, or in managing and containing, any default. Prolongation of the existing uncertainty is itself potentially damaging to the domestic and international markets and could affect our business recovery.

Recent Market Behavior and Implications for the Future

As summarized on Table I, outstanding publicly held securities of New York City alone, totaling $12.3 billion on June 30, 1975, accounted for about 5.8 percent of total tax-exempt debt nationwide. The short-term City debt of $4.5 billion accounted for a much larger fraction, some 24.3 percent, of the comparable national total. In recent months, as the Table shows, about $2 billion of the City's debt has been refinanced under the auspices of the State Municipal Assistance

Corporation. This has cut City securities (long and short-term) outstanding in the market to some $10.3 billion, but MAC securities have of course taken their place.

While I do not have precise data, holdings of City debt by the nation's commercial banks appear to total nearly $3 billion. The rest is largely unidentified as to holder, but individuals presumably account for the bulk of the total. There are cases of particular banks with exceptionally heavy concentrations of City debt relative to their capital or assets, but these cases are almost entirely confined to smaller institutions rather widely scattered over the country. These exceptional cases of concentrated holdings relative to capital do not include the large money market banks in New York City itself.

While the total amount of New York City debt is certainly significant, it would not, in itself, mean that major national or international repercussions would follow from default. We should not lose sight of the fact that the securities will ultimately be repaid, and they will retain value.

However, the scope of the problem cannot be defined by looking only at the City. Consequences have already been felt by the State. Certain of its agencies have been affected, particularly those agencies involved in a variety of social programs--housing, dormitories, hospitals, and nursing homes--whose

ultimate financial health is intimately related to that of the State. Currently, direct obligations of the State and the securities of affected agencies taken together amount to more than the City's outstanding debt. Some $5 billion are short-term. While a part of this debt is seasonal, the agencies have a more or less continuous problem of refinance and the State will have substantial financial needs beginning in March or April of 1976.

With so significant a fraction of the municipal bond market more or less directly related to the financial difficulties of New York, repercussions on the market generally are not surprising. As shown in Chart I, yields on municipal securities in general have risen significantly in recent months. The spread between high and lesser grade issues is now at historic highs. These developments should not, in my judgment, be traced entirely, and probably not even primarily, to the New York City situation. There has been an exceptionally heavy volume of municipal financing this year, continuing through the summer. This financing came at a time when many banks and other institutional investors were not eager for additional tax-exempt income. The larger premiums paid for quality appear characteristic of all markets, and began well before the New York situation became critical.

However, I have no doubt that uncertainties generated by the New York situation have contributed to problems for a number of other State and local governments in recent weeks and months, and the statistics cannot capture the full effect. Scattered reports of extraordinarily high interest rates, ranging to 11 or 12 percent, for new offerings of more obscure or weaker credits have appeared; in a number of instances, municipalities accustomed to a number of bids for their security offerings have been faced with a single bid or none at all; in a few cases, they have had to resort to private financing; and in some apparently rare instances, the money has simply not been made available in the desired volume or at all.

I cannot tell the extent to which these developments (and somewhat similar developments in the corporate market) would be further aggravated by default by the City of New York. As I indicated earlier, I believe a great deal would depend upon prospects for limiting default to the City itself--in other words, upon confirmation that a "domino effect" will not appear. A great deal would depend, too, upon the market valuation of New York City securities. Those securities are today heavily discounted when they trade at all. Effective yields are quoted at 20 percent or more for short-dated securities, and prices of longer-term bonds have in some cases declined to less than half their par value. If the prospect of default were to be effectively eliminated, prices could, of course, be expected to recover substantially. Even if there were a default, an orderly and credible restructuring plan could sustain and even enhance confidence in the ultimate value of the securities.

The absence of any dramatic impact on the banking system thus far seems to me to reflect a correct appreciation of the fact that the direct exposure of major banks is limited, and that the Federal authorities--most particularly the Federal Reserve--have ample means at their command to meet either general liquidity needs or pressures on individual banks.

Confidence on this point does not, however, mean that the situation carries no dangers for the national economy. In recent months and years, we have seen a tendency for business failures to rise, and with that, an increased need for banks and others to write down bad loans. This situation has arisen during a period when--partly because of inflation--capital positions of both banks and their customers have been under more pressure than earlier.

Fortunately, the earnings flow of many banks has otherwise improved, and with recovery underway, the outlook for corporate profits generally is better. But, in current circumstances, the problems of New York can only contribute to more conservative--possibly overly conservative--attitudes by lenders--and, therefore, to more costly and difficult financing for businesses, housing, and municipalities in cases where credit standing is not of the highest quality. At best, the result will be some potential drag on prospects for home-building, plant and equipment outlays, and state and local spending. In terms of overall economic activity, that drag can be countered by monetary and fiscal policies. But should the situation become seriously aggravated, at some point the process of recovery could be impaired, and not easily maintained by highly generalized monetary and fiscal measures.

In an open economy like that of the United States, and particularly in the light of the extremely heavy flows of banking deposits and investment funds internationally, questions have also been raised concerning the international consequences and repercussions of the New York City situation. The United States would of course be affected by any impact on the exchange rate of the dollar and by shifts of foreign funds among various institutions or investment media. Foreign countries are in turn affected by, and concerned about, any major changes in the American economic outlook or in the general credit situation.

Fortunately, as may be seen in Chart II, the dollar has been on a strongly rising trend since Spring, reflecting our strong trade balance, growing confidence in the strength of business recovery, and relatively higher interest rates in this country. In the most recent weeks, that trend has been interrupted; the dollar has declined erratically vis-a-vis important continental European currencies. Concern and uncertainty about the possible repercussions of the New York situation appear to have been a factor in this reversal. But it has not been the only factor; for instance, some declines in our interest rates relative to those abroad my have been at least as important.

At least until recently, my impression is that foreigners have not given much credence to the possibility of default. The Constitutional and traditional pattern of Federalism in the U.S.--with the cities being creatures of our States and with the States having sovereign powers--is not deeply understood abroad. Perhaps as a result, I have found that foreign officials or bankers have somewhat different attitudes toward the default of New York City than many Americans. The sophisticated foreigner is very much aware that large urban centers may have massive financial problems, because some of their own cities are in difficulty as well. What they find less comprehensible, against their own experience, is that a national government in the last analysis would permit an outright default of its major city, for in most instances in their countries there is a much more intimate financial relationship between local and national governments. Consequently, the foreigner may react more to the symbolism of default, should it occur, than would Americans.

For that reason, the international repercussions are even less predictable than the domestic. However, in the end, the attitude of foreign investors is likely to be influenced by the way we handle the situation and reactions of our own investors. To the best of my knowledge, no

significant amount of State or local paper is held abroad; in that sense foreigners are not at risk. Foreign investors, paralleling the tendencies of American investors, might wish to place a greater premium on "quality" in placing funds in the United States. Because the great bulk of foreign investment is already conservatively handled in this respect, the effects need not be great. Possibly more troublesome would be shifts of funds out of dollars, bringing at least transient pressures on the exchange rate, particularly if short-term interest rates on high-quality instruments fall in the wake of a default. In the context of our present exchange rate system, slippage of the exchange rate should not be equated with crisis. We have adequate means to maintain orderly trading, and in the end the exchange rate will reflect the overall health of the economy, and particularly the evidence others see that we persist in bringing inflation under control.

The problem could of course be aggravated if the U.S. business recovery were severly affected or if confidence in American institutions generally were to be undermined. Foreign sensitivity in a sense does raise the stakes all around. It reinforces the need, if a default is not avoided, to contain its effects.

Appraisal of the Financing Needs of New York City, the State, and the State Agencies

I have emphasized that the severe economic, budgetary, and financing problems of New York City must be viewed in the context of the concurrent financing problems of the State and its agencies. While the State and its agencies are basically in a much stronger underlying position than the City, they have already been impacted to the point that recent new financing had to be arranged from official sources, and normal market financing at this time is impossible in any volume.. Therefore, no "answer" to the problems presented by the plight of the City can be satisfactory or complete unless confidence can be restored with respect to these entities as well.

1. The State

While its relative position has declined over the past decade, reflecting a sluggish pattern of economic growth, New York State still ranks as one of the nation's wealthiest, measured by per capital income. By most measures, its tax burden is also highest. Taxes of New York State and local governments together took almost 16 percent of 1973 personal income, 37 percent higher than the national average (see Table II). Its total indebtedness (direct, lease purchase and moral obligation) has increased

from $2.4 to $12.5 billion in the last decade, substantially faster than the national average. Most of this increase has been accounted for by agencies; in relative terms, the direct long-term debt of the state has grown much more modestly, from $1.2 to $3.3 billion. But on June 30, 1975, after heavy seasonal borrowing, the State's direct short-term debt stood at over $3 billion.

The combination of high expenditures, resistance to increases in already high taxes, and recession have combined to produce a difficult budgetary problem for the State, with a reportedly sizable deficit ranging to as much as $600 million or more for the year ending April 30, 1976. A shadow was first cast over the traditionally high credit standing of the State when it failed to respond to the financial difficulties of one of its agencies, the Urban Development Corporation, in time to make possible timely repayment of a maturing obligation. While that technical default of a weak agency was repaired, it did help to sensitize investors to potential problems. Later involvement with New York City problems, requiring substantial financing, potentially aggravated the State's budget position and raised further questions. In the event, the State found that, after promising to lend money to the City, its capacity to borrow in the market to make good on that pledge was strictly limited. It had to turn to state pension funds and other funds under its own control.

In the absence of further support to the City beyond current commitments--and if it were assumed that aid to its agencies will not be necessary--my understanding is that the State can avoid any further market borrowing until late March or April. Substantial funds will be needed in Spring to meet budgetary commitments, including large payments for local aid.

Because the market is now not open to it in size, the ability of the State at present to effectively assist the City is at best limited. Logically, its first priority must be to repair its own credit standing, a matter that would certainly seem to be within its remaining taxing capacity.

2. The State Agencies

There are two large State agencies--the Housing Finance Agency and the Dormitory Authority--with large amounts of debt outstanding that must be rolled over. Moreover, additional debt must be issued if projects under construction are to be completed, and thus brought to the point of producing revenues needed for debt service. Both agencies are designed to be, and have been, self-supporting; both have debt that carry a "moral obligation" by the State to supplement, through the State appropriation process, the future flow of revenues in amounts sufficient to

cover the debt service on bonded indebtedness. Unlike the UDC, both agencies have normally enjoyed high standing in the market.

For the two agencies together, about $1.5 billion of bond anticipation notes need to be rolled over or funded in the next year, averaging over $100 million a month. Additional sizable borrowings would be needed to complete current projects. Yet, as matters stand, neither agency can finance that volume of activity in the market. High interest costs on recent borrowings and new doubts about the economic strength of projects located in New York City have been a factor affecting investor appraisal of credit worthiness, quite possibly to an unwarranted degree given their "track record".

Default by one of these agencies (or by one of the State's much smaller agencies) would affect the credit of the State itself, raising a further barrier to its reentry into the market. In such circumstances, the possibility of containing the repercussions of default by the City would be substantially diminished. At the very least, it seems clear that the State must now assume greater responsibility for the financial viability of these agencies. To the extent the State provides money to assist the agencies, there would, of course, be an additional drain on the State budget, reducing further its capacity to help the City.

3. The City

The magnitude of the City's financial problem has long been obscured by arcane bookkeeping and misleading budgetary practices. However, progress is being made in developing more reliable and consistent estimates.

The City's current operating budget was estimated to be in deficit by some $800 million prior to the recently announced cuts approved by the Emergency Financial Control Board. That is equivalent to about 7 percent of total operating expenditures. Perhaps a better measure of the size of the budgetary challenge is the fact that the deficit is equivalent to some 15 percent of the expenditures financed by the City itself, excluding debt service and its mandated share of welfare costs. (About 35 percent of this year's budget will be financed by State or Federal aid, largely related to mandated expenditure programs.) In a City already very heavily taxed, faced in recent years with large losses in jobs and outward movement of business and, therefore, with little natural bouyancy in revenues, the chance of increased City tax rates being of real assistance is, at the best, limited.

Apart from the operating deficit, the Emergency Financial Control Board has just estimated that expense items still carried in the City's capital budget should total between $600 - $700 million. Even if capital spending is confined to existing projects and essential repairs, it has estimated the amount of additional cash required this year could be of comparable or larger size. These cash drains include about $1 billion of maturing long-term debt, carried in the operating budget. But it is clear that the total debt of the City will rise a billion dollars or more this year, even with new economies now planned.

Apart from the rise in the debt over the fiscal year as a whole, the city experiences substantial seasonal drains in its revenue flows through the late winter. Part of the seasonal and operating deficit has already been financed. However, the EFCB has estimated that, even if the City defaulted and refused to pay interest and redeem any maturing securities, the City would have need for more than $1 billion over the next six months. Payment of interest would add to this need.

These peak totals could conceivably be reduced if some revenues could be advanced to help meet seasonal needs. But the basic point remains; even in default cash needs will be substantial.

The keystone of any program to avoid or to manage default must be a most stringent budgetary program--a program that provided reasonable assurance of balance or surplus in the operating budget, and some net debt reduction, over a limited period of time. Moreover, that program must be achieved without undermining the economic base for the future. Even with such a program, some source of interim financing, beyond the amount of debt maturing, appears necessary if default is to be avoided, or, if default is to occur, to assure that it be managed in an orderly manner.

Conclusion

The full implications of default by New York City cannot be foreseen with any confidence. Some of the probable effects are already apparent. The risk of actual default producing substantially more serious consequences nationally and internationally, with troublesome implications for economic activity, is related in the first instance to the ability of the State of New York and its agencies to maintain their financial equilibrium. A crucial ingredient in the outcome would be the speed with which a realistic,

credible plan of budgetary balance and reform, debt restructuring, and interim financing can be achieved for the City. Those ingredients seem to be essential to any successful approach to the New York situation, whether default occurs or not.

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Attachments

Table I

New York City--Debt Position
(Dollars in billions)

	June 30, 1975	Maturities to date	Balance (Col. 1 less Col. 2
Issued Publicly:			
Long-term	$ 7.8	$ .4	$ 7.4
Short-term	4.5	1.6[a]	2.9
TOTAL	$12.3	$2.0	$10.3

a/ Does not include $.1 billion in short-term notes rolled over.

NOTE: This is not an official statement of the City of New York. The figures contained herein are Federal Reserve Bank of New York estimates based on data obtained from various sources.

Federal Reserve Bank of New York
October 21, 1975

Table II

State and Local Taxes as a Percentage of Personal Income

	State Taxes as a Percentage of Personal Income		State and Local Taxes as a Percentage of Personal Income	
	New York	Total U. S.	New York	Total U. S.
1963	4.8	4.8	11.0	9.5
1968	5.9	5.3	12.2	9.8
1973	7.9	6.5	15.8	11.5

Note: Taxes are measured on the basis of fiscal years ended in the respective years shown. Personal income is measured on a calendar year basis.

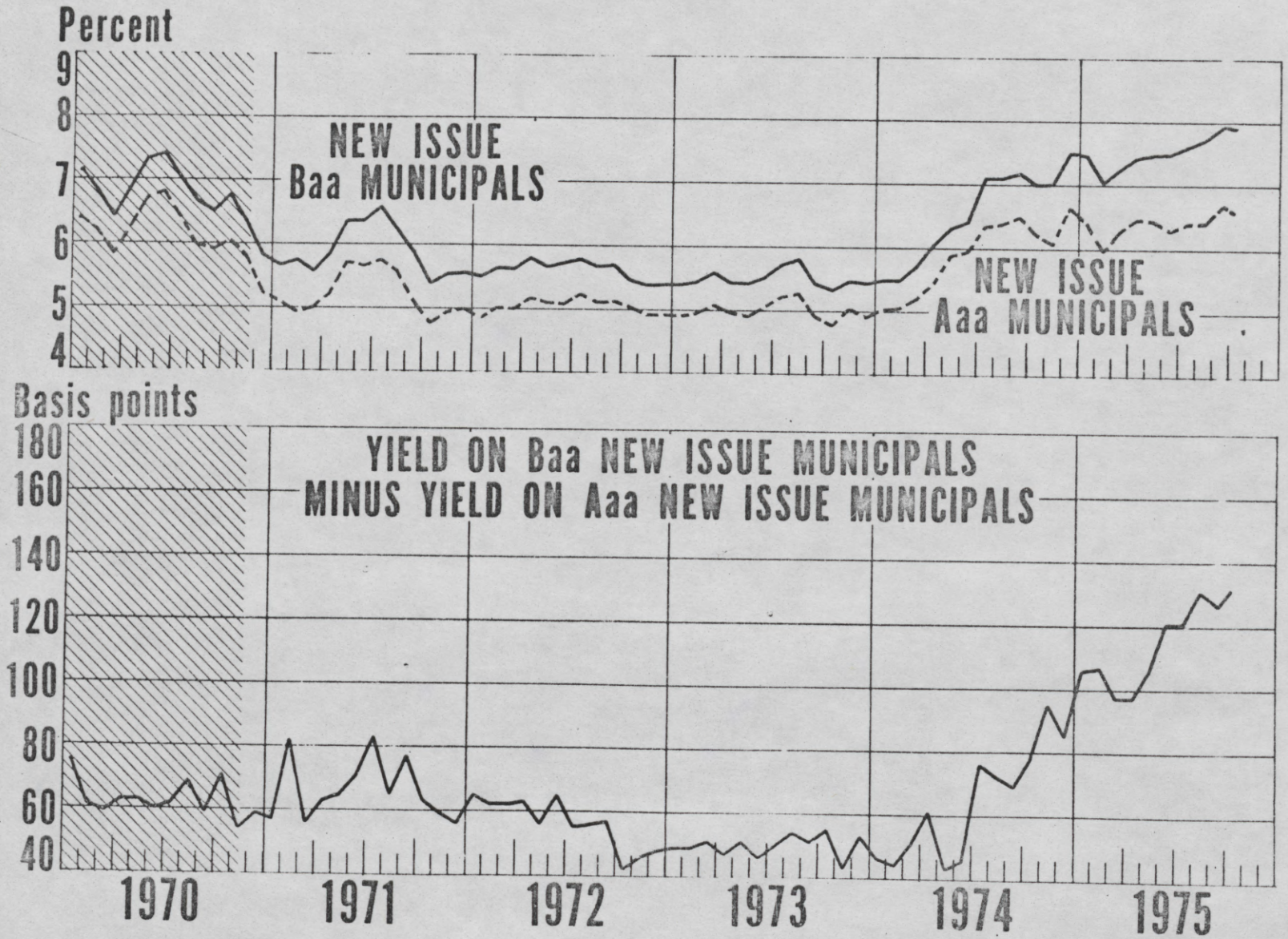
Sources: U. S. Bureau of the Census, Governmental Finances (various issues); and U. S. Department of Commerce, Bureau of Economic Analysis, Survey of Current Business.

Federal Reserve Bank of New York
October 21, 1975

Chart I

October 21, 1975

YIELD SPREADS BETWEEN LOW AND HIGH QUALITY MUNICIPAL BONDS



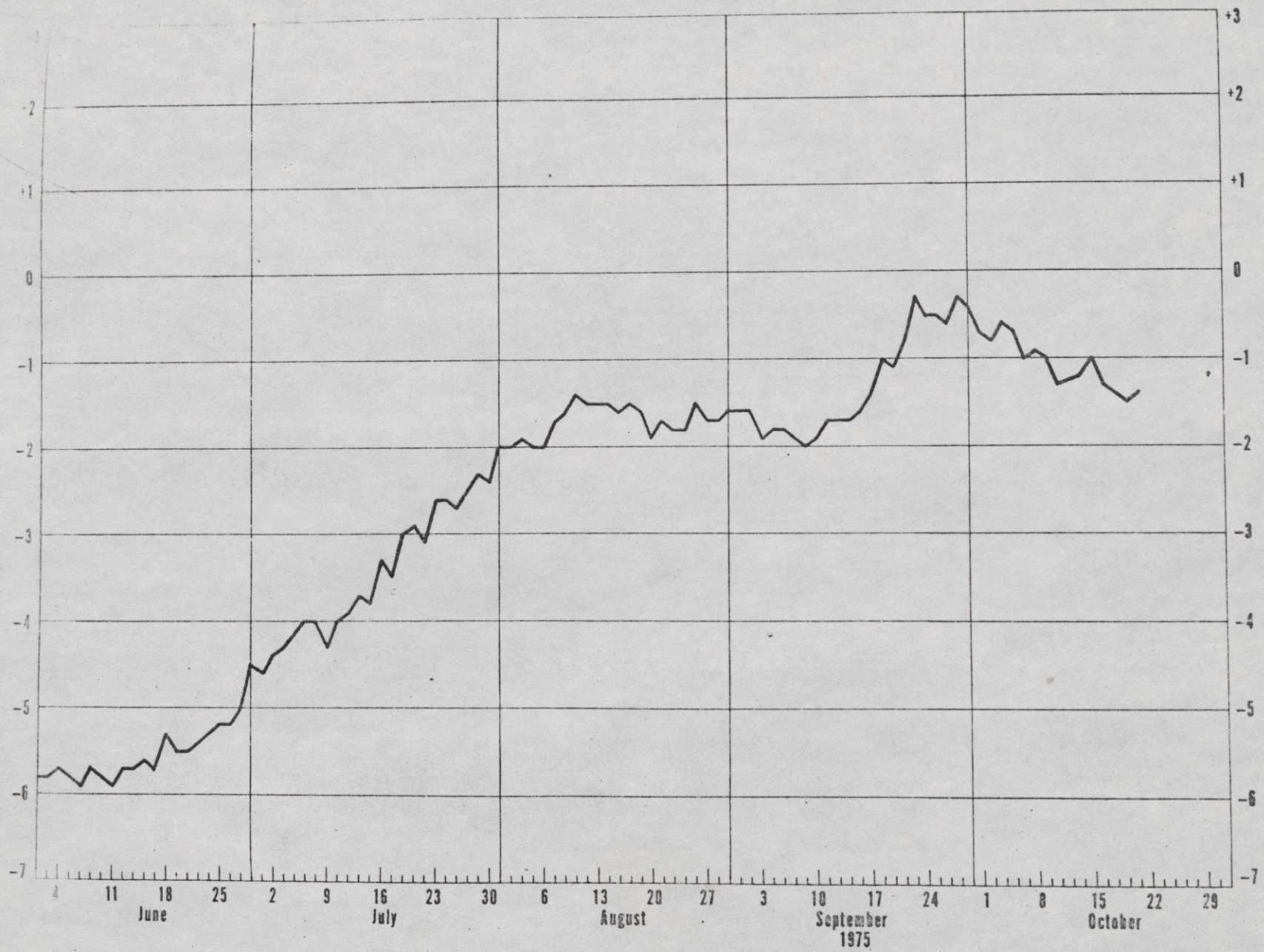
Note: Data are monthly averages except for the last plotting, which is as of October 16, 1975.

Source: Moody's Investors Service, Inc.

EFFECTIVE RATE OF EXCHANGE OF THE DOLLAR

October 21, 1975

AGAINST CURRENCIES OF 13 MAJOR INDUSTRIAL COUNTRIES, EXPORT-WEIGHTED



Note: The effective value of the dollar is measured in terms of the deviation of daily New York offered rates for foreign currencies from Smithsonian central rates. The last plotting is as of October 21, 1975.

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78; S. 785.

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President

8/8/78; H.R. 11832.

Disarmament Act with respect
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Rept. 95-1048
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Public Law 95-339 Approved 8/8/78; H.R. 12426.

New York City Loan Guarantee Act - *Title I: Loan Guarantees* - Authorizes the Secretary of the Treasury to guarantee, under stated conditions, the payment of principal and interest on indebtedness of the City of New York. States that the maximum length of any guarantee provided shall be 15 years after the date of the issuance of the city indebtedness involved. Restricts city indebtedness guarantees under this Act to employee pension funds of the city and the State. Terminates such guarantees whenever the indebtedness is disposed of or sold.

Requires the Secretary to assess and collect, at least annually, a guarantee fee of not less than one-half of one percent per year on the outstanding principal amount of guaranteed securities. Authorizes the Secretary to periodically escalate such fee to induce the obligor to enter the public credit market.

Sets forth conditions of eligibility which must be met before the Secretary guarantees or commits to guarantee any city indebtedness, including, but not limited to: (1) the city is unable to obtain credit elsewhere and (2) the city has submitted to the Secretary a plan for bringing its expenditures other than capital items into balance with its revenues for each of the first three fiscal years of the city beginning June 30, 1978, and submits, on or before the first day of each fiscal year thereafter, plans for bringing such expenditures into balance with its revenues no later than the final fiscal year of the four year period beginning July 1, 1978.

Requires the independent fiscal monitor to demonstrate to the satisfaction of the Secretary that it has the authority to control the city's fiscal affairs during the entire period in which Federal guarantees are outstanding. Conditions the making of such guarantees upon the city's agreement to obtain annual audits conducted by independent public accountants of its financial statements and establish an audit committee which shall assist in such audits. Sets forth requirements the State of New York must fulfill to be eligible for such guarantees including assurance that State financial assistance of an equal amount would be provided to the city during the city's 1979 fiscal year. Requires the State to establish a State reserve fund to reimburse the Treasury for paying any interest and principal which the city fails to pay and of which payment is guaranteed under this Act.

Stipulates that a productivity council be established to develop and implement methods to increase employee productivity. Directs the independent fiscal monitor to review and report annually on the work of the council.

Requires the city to offer to sell short-term notes in fiscal years 1980, 1981, and 1982, and long-term bonds in fiscal years 1981 and 1982. List additional terms and conditions including, but not limited to, the agreement by the city to implement a program of refunding any outstanding indebtedness guaranteed under this Act. Limits the total amount of guarantees that may be outstanding at any time to $1,650,000,000. Allows the Secretary to guarantee the payment of principal and interest on city indebtedness issued prior to January 1, 1979, and maturing prior to July 1, 1979, upon the determination that the employee pension funds are not able to provide sufficient amounts of seasonal financing required pursuant to this Act without being considered to have failed to meet the requirements of, or to be in violation of, the Internal Revenue Code of 1954.

Directs the Secretary to enforce any right accruing to the United States as a result of the issuance of guarantees on city-related securities. Authorizes the Secretary to bring a civil action in any United States district court or appropriate court to enforce compliance with this Act, any related agreement, or any provision of State law, by the city, the State, the independent fiscal monitor, or any other official or other party.

Authorizes the Secretary and the Comptroller General to inspect all accounts, books, records, and other specified transactions relating to the city's financial affairs and indebtedness.

Terminates the authority of the Secretary to guarantee city indebtedness on June 30, 1982.

Authorizes appropriations without fiscal year limitation of such sums as may be necessary to carry out the provisions of this Act.

Title II: Amendments to the Internal Revenue Code of 1954 - Makes interest income received on any obligation guaranteed under Title I of this Act with respect to interest accrued during the period such guarantee is in effect taxable under the Internal Revenue Code of 1954. Stipulates that no provision of law shall be construed as authorizing the Federal Financing Bank to acquire such obligations.

Public Law 95-340

5-10-78 Reported to House from the Committee on Banking, Finance and Urban Affairs, H. Rept. 95-1129 (Part I)
5-22-78 Reported to House from the Committee on Ways and Means with amendment, H. Rept. 95-1129 (Part II)
6-07-78 Measure called up by special rule in House
6-07-78 6-08-78, Measure considered in House
6-08-78 Motion to recommit to the Comm. on Bank., Fin. & U. Affrs. with instructions rejected in Hse.,r.c. #431(109-291)
6-08-78 Measure passed House, amended, roll call #432 (247-155)
6-09-78 Referred to Senate Committee on Banking, Housing and Urban Affairs
6-23-78 Reported to Senate from the Committee on Banking, Housing and Urban Affairs with amendment, S. Rept. 95-952
6-28-78 Measure called up by unanimous consent in Senate
6-28-78 6-29-78, Measure considered in Senate
6-29-78 Measure passed Senate, amended, roll call #197 (53-27)
6-29-78 Conference scheduled in Senate
7-10-78 Conference scheduled in House
7-18-78 Conference report filed in House, H. Rept. 95-1369
7-25-78 House agreed to conference report, roll call #595 (244-157)
7-27-78 Senate agreed to conference report, roll call #258 (58-35)
7-28-78 Measure enrolled in House
7-28-78 Measure enrolled in Senate
7-28-78 Measure presented to President
8-08-78 Public Law 95-339

Public Law 95-340 Approved 8/11/78; H.R. 12138.

Designates a specified Federal building in Laguna Niguel, California, as the "Chet Holifield Building."

5-19-78 Reported to House from the Committee on Public Works and Transportation, H. Rept. 95-1210
6-05-78 Measure called up by consent calendar in House
6-05-78 Measure considered in House
6-05-78 Measure passed House
6-07-78 Referred to Senate Committee on Environment and Public Works
7-25-78 Reported to Senate from the Committee on Environment and Public Works, S. Rept. 95-1038
7-28-78 Call of calendar in Senate
7-28-78 Measure considered in Senate
7-28-78 Measure passed Senate
7-31-78 Measure enrolled in House
7-31-78 Measure enrolled in Senate
8-01-78 Measure presented to President
8-11-78 Public Law 95-340

Public Law 95-341 Approved 8/11/78; S.J. Res. 102.

States that it shall be the policy of the United States to protect and preserve for Native Americans their inherent right of freedom to believe, express, and exercise their traditional religions. Requires the President to direct the various Federal departments, agencies, and other instrumentalities whose duties impact on the religious practices of Native Americans to evaluate their policies and procedures in consultation with Native religious leaders in order to determine and implement the changes necessary to protect and preserve Native American religious cultural rights and practices. 7/18/78 hfac080 Measure passed House, amended, in lieu of H. J. Res. 738

Declares that it shall be the policy of the United States to protect and preserve the traditional religions of American Indians.

Requires the President to direct the Federal departments and agencies to evaluate their policies and procedures in consultation with native traditional religious leaders to determine appropriate changes necessary to protect Native American religious cultural rights and practices.

3-21-78 Reported to Senate from the Select Committee on Indian Affairs with amendment, S. Rept. 95-709
4-03-78 Call of calendar in Senate
4-03-78 Measure considered in Senate
4-03-78 Measure passed Senate, amended
4-05-78 Referred to House Committee on Interior and Insular Affairs
7-18-78 Measure called up by unanimous consent in House
7-18-78 Measure considered in House
7-18-78 Measure passed House, amended, in lieu of H. J. Res. 738
7-27-78 Senate agreed to House amendment
7-31-78 Measure enrolled in House
7-31-78 Measure enrolled in Senate
8-01-78 Measure presented to President
8-11-78 Public Law 95-341

Public Law 95-342 Approved 8/11/78; S. 920.

Authorizes the State of Oklahoma to convey oil and gas mineral leases to those lands situated within the project designated as the Lake Murray Recreational Demonstration Area in Carter County, Oklahoma. Directs the State of Oklahoma to surrender the present deed and the United States to issue a new deed to the State of Oklahoma for such lands, which deed shall include oil and gas exploration and development as permitted uses, conditioned on approval of development plans by the Secretary of the Interior and assurances that such development will preserve the natural, scenic, and recreational values of the Demonstration Area to the maximum extent possible. Requires the State of Oklahoma to pay to the Secretary 50 percent of all of the gross proceeds received from oil and gas development on the lands subsequent to the issuance of the deed. Directs the Secretary to deposit such sums paid into the general fund of the Treasury as miscellaneous receipts.

10-20-77 Reported to Senate from the Committee on Energy and Natural Resources with amendment, S. Rept. 95-523
10-27-77 Placed on calendar in Senate under Measures Cleared to be Considered by Unanimous Consent
10-28-77 Measure called up by unanimous consent in Senate
10-28-77 Measure considered in Senate
10-28-77 Measure passed Senate, amended
10-31-77 Referred to House Committee on Interior and Insular Affairs
5-15-78 Measure called up by committee discharge in House
5-15-78 Measure considered in House
5-15-78 Measure passed House, amended, in lieu of H.R. [illegible]
7-21-78 Senate agreed to House amendment with an amendment
7-28-78 House agreed to Senate amendments
7-31-78 Measure enrolled in House
7-31-78 Measure enrolled in Senate
8-01-78 Measure presented to President
8-11-78 Public Law 95-342

Public Law 95-343 Approved 8/11/78; S. 2463.

Amends the Surface Mining Control and Reclamation Act of 1977 by authorizing to be appropriated $25,000,000 for fiscal year 1979; such additional amounts as necessary for salaries and retirement and other employee benefits; and such sums as may be required for fiscal year 1980.

Authorizes appropriations of $25,000,000 for each of the fiscal years 1979 and 1980 for determining hydrologic consequences and performing test borings for specified coal operators.

5-09-78 Reported to Senate from the Committee on Energy and Natural Resources with amendment, S. Rept. 95-788
5-16-78 Call of calendar in Senate
5-16-78 Measure considered in Senate
5-16-78 Measure passed Senate, amended
7-11-78 Measure called up by unanimous consent in House
7-11-78 Measure considered in House
7-11-78 Measure passed House, amended, in lieu of H.R. 11827
7-28-78 Senate agreed to House amendments
7-31-78 Measure enrolled in House
7-31-78 Measure enrolled in Senate
8-01-78 Measure presented to President
8-11-78 Public Law 95-343

C. L.

July 24, 1978

TO: Board of Governors

FROM: Jay Brenneman JGB

SUBJECT: Conference Report on NYC Financial Assistance Act of 1978 (H.R. 12426)

The conference committee has reached agreement on the subject legislation, which is scheduled for a final vote in the House tomorrow and in the Senate tomorrow or Wednesday.

As approved by the conferees, H.R. 12426 would authorize the Secretary of the Treasury to guarantee up to $1.65 billion in aggregate principal (but excluding interest) of taxable NYC obligations, at a minimum fee of 1/2 per cent per annum payable on any outstanding guaranteed securities. The guarantee authority (a) would be restricted to securities purchased and held by pension funds of the city or state; (b) could be used for seasonal or long-term financing within the limitations described below; and (c) would terminate on June 30, 1982. No direct loan authority is provided by the legislation.

The $1.65 billion guarantee authority would be available in accordance with the following schedule and conditions:

--FY 1979- $750 million, with ceilings of $500 million for long-term loans and $325 for seasonal financing. The latter, however, would be available only to city indebtedness issued before January 1, 1979; would have to be repaid before July 1, 1979; and could be used only if the city pension funds have reached the limit of their legal lending ability.

--FY 1980- $250 million for long-term guarantees, plus the carryover of any unused portion of the $750 million authority for FY 1979; all of which would be available only for long-term guarantees, and would be subject to a one-House veto.

--FY 1981- $325 million for long-term guarantees only, plus the carryover of any unused portion of FY 1979 and 1980 authority; all of which would be subject to a one-House veto.

--FY 1982- $325 million for long-term guarantees only, subject to achievement of a balanced budget in accordance with generally accepted accounting principles; plus the carryover of any unused portion of FY 1979, 1980, and 1981 authority.

Short-term guarantees for seasonal financing would thus be authorized for FY 1979 only; and all long-term loan authority would carry maximum maturities of 15 years.

Other basic conditions, most of which were retained from the Senate version of the legislation, include: (1) requiring NYC to use at least 15 per cent of the proceeds from its annual long-term borrowing after 1982 to repay Federally guaranteed loans (subject to waiver by the Secretary of the Treasury), (2) specifying independent auditing procedures both to

precede and follow extension of guarantees; (3) requiring New York State to maintain its 1979 level of aid to the City throughout the period of guarantees, except during any fiscal year that the City budget is balanced; (4) requiring New York State or an agency thereof to co-insure 5 per cent of the amount of the guaranteed obligations; (5) compelling New York City to test its ability to re-enter the credit markets in 1980, 1981, and 1982; (6) authorize the Secretary of the Treasury to go to court to enforce loan agreements made under the Act; and (7) requiring the City to establish a Productivity Council.

Two more legislative actions must occur, in addition to the final approval of H.R. 12426, before Federal loan guarantees can be issued to NYC: (1) passage of an appropriations bill and (2) extension of Public Law 94-236, which preserves the tax-exempt status of NYC pension funds as long as they are participating in city financings. H.R. 12426 authorizes "such sums as necessary" for carrying out the provisions of the legislation, to be appropriated beginning October 1, 1978 "and to remain available without fiscal year limitation. . . ." Treasury and New York State contacts inform us that multi-year appropriations legislation is expected to be enacted without delay. The bigger problem is P.L. 94-236, which technically remains in effect through December 31, 1978, but which expired in effect on June 30 inasmuch as it was tied to the 1975 Seasonal Loan Program. Without reinstatement, it cannot be used for new financing arrangements as under H.R. 12426; and although Treasury Department has urged appropriate Congressional action, none has been initiated to date.

cc: Messrs. Allison, Axilrod, Coyne, Ettin, Jones, Keir, Kichline, McKelvey, Petersen, Prell, Raiken; Mss. Marx and Minehan
President Volcker
Ned Guy

C. L.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 14, 1978

To Mr. Michael Prell

Subject: New York City Federal Loan Guarantees

From Carol S. Marks

The following conditions were agreed to by House-Senate conferees on Thursday, July 13, regarding federal loan guarantees for New York City.

A. Amount

1. $1.65 billion long-term federal guarantees

Year	NYC FY	Amount	Specific Conditions
1	1979	$500m	---
2	1980	$500m	one-house veto
3	1981	$325m	one-house veto
4	1982	$325m	achievement of a balanced budget according to generally accepted accounting principles (GAAP).

2. Up to $235 million seasonal guarantees

   a. available only during the first six-months of the City's fiscal year which began July 1.

   b. available only if city pension funds have reached the limit of money they can legally lend to the City and state pension funds meet the City's seasonal needs.

   c. repayment must be made before start of FY 1980.

B. Maturities of bonds have a 15-year maximum.

C. Bond purchases will be limited to State and local pension funds.

D. An independent committee will be established to make annual audits of the City's finances.

E. State will be required to maintain the same level of aid that it is making this year.

F. State or State agency must coinsure 5% of the amount of the guarantees.

G. City must sell short-term notes to the public in 1980, 1981 and 1982 and long-term bonds in 1981 and 1982.

H. After 1982, 15 per cent of any city debt must be used to repay and refund the guaranteed bonds, unless the Treasury Secretary waives the requirement.

It is reported that this bill (#12426) will pass House and Senate chambers by the end of next week.

NEW YORK CITY LOAN GUARANTEE ACT OF 1978

29-139 O - 78 (137)

Public Law 95-339
95th Congress

Aug. 8, 1978
[H.R. 12426]

An Act

To authorize the Secretary of the Treasury to provide financial assistance for the city of New York.

New York City Loan Guarantee Act of 1978.

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

31 USC 1521 note.

SHORT TITLE

SECTION 1. This Act may be cited as the "New York City Loan Guarantee Act of 1978".

TITLE I—LOAN GUARANTEES

31 USC 1521.

DEFINITIONS

SEC. 101. For the purpose of this title, the term—

(1) "city" means the city of New York;

(2) "State" means the State of New York;

(3) "Secretary" means the Secretary of the Treasury;

(4) "independent fiscal monitor" means an agency, board, or other entity authorized by the law of the State which has the authority to control the fiscal affairs of the city during the entire period for which assistance under this title will be outstanding and which authority the State has covenanted will not be substantially impaired during such period;

(5) "financing agent" means any agency or instrumentality of the State duly authorized by the law of the State to act on behalf of or in the interest of the city, and no other subdivision of the State, with respect to the city's financial affairs;

(6) "city indebtedness" means indebtedness for borrowed money of (A) a financing agent, but only if the proceeds thereof are advanced to or applied for the benefit of the city, or (B) the city; and

(7) "fiscal year" means a fiscal year of the city, except in section 111.

31 USC 1522.

GUARANTEE AUTHORITY

SEC. 102. (a) Upon the written request of the city and the Governor of the State, the Secretary may guarantee the payment, in whole or in part, of interest, principal, or both, of city indebtedness in accordance with this title, but any such guarantee shall cease to be effective not later than fifteen years after the date of the issuance of the city indebtedness involved.

(b) A guarantee under this title is effective only with respect to city indebtedness which is issued or is to be issued to employee pension funds of the city or of the State, or of any agency of the city or of the State, and shall terminate whenever such indebtedness is sold or otherwise disposed of by such a fund (other than to a successor in interest not involving a change in beneficial ownership).

(c) Whenever the payment of principal and interest on city indebtedness is guaranteed under this title, the Secretary shall assess

and collect from the issuer, no less frequently than annually, a guarantee fee computed daily at a rate of no less than one-half of 1 per centum per annum on the outstanding principal amount of city indebtedness guaranteed hereunder. All funds received by the Secretary in payment of such fees shall be paid into the general fund of the Treasury. The Secretary may periodically escalate the guarantee fee to induce the obligor to enter the public credit markets.

CONDITIONS OF ELIGIBILITY

SEC. 103. The Secretary may make guarantees under this title only if— 31 USC 1523.

(1) there is a reasonable prospect of repayment of the city indebtedness to be guaranteed in accordance with its terms and conditions;

(2) the Secretary determines that the city is effectively unable to obtain credit in the public credit markets or elsewhere in amounts and terms sufficient to meet the city's financing needs;

(3) the interest rate on such city indebtedness is reasonable, taking into consideration current average market yields for other obligations guaranteed by the United States;

(4) during the four-year period ending June 30, 1982, the long-term and seasonal borrowing needs of the city (other than borrowing assisted or to be assisted under this title) will be met through commitments from the State, an agency of the State, private sources, or through public credit markets, in amounts which will be sufficient to enable the city, when the guarantee authority conferred by this title has terminated, to meet all of its long-term and seasonal borrowing needs through the public credit markets, and for the purpose of making such determination, the Secretary may assume that all other conditions under this section are and will be fulfilled;

(5)(A) the independent fiscal monitor is requiring the city to adopt and adhere to budgets covering all expenditures other than capital items, the results of which would not, for fiscal years of the city beginning after June 30, 1981, show a deficit when reported in accordance with generally accepted accounting principles and, for fiscal years of the city beginning on or prior thereto but after June 30, 1978, to make substantial progress toward that goal, and, for each fiscal year of the city beginning prior to June 30, 1981, but after June 30, 1978, is requiring the city to adopt and adhere to budgets covering all expenditures other than capital items, the results of which would not show a deficit when reported in accordance with accounting principles established under State law;

(B) the city has submitted to the Secretary, with the approval of the independent fiscal monitor, in such detail and in accordance with such accounting principles as the Secretary may prescribe, a plan for bringing all of its expenditures other than capital items into balance with its revenues for each of the first three full fiscal years of the city beginning after June 30, 1978, and the city agrees to publish, after the completion of each fiscal year covered by the plan, an analysis reconciling its actual revenues and expenditures with projected revenues and expenditures, and to publish periodic projections which reflect the impact of the plan on tax rates; and

(C) the city submits, with the approval of the independent fiscal monitor, in such detail as the Secretary may prescribe and in accordance with generally accepted accounting principles, a plan for bringing all of its expenditures other than capital items into balance with its revenues no later than the final fiscal year of the four year period which begins with the fiscal year beginning July 1, 1978, and the city is required, on or before the first day of each fiscal year thereafter during which city indebtedness guaranteed under this title is outstanding, to have prepared and submit a plan covering the four year period beginning with such fiscal year which will result in budgets which would not show a deficit when reported in accordance with accounting principles set forth in subparagraph (A);

(6) the independent fiscal monitor demonstrates to the satisfaction of the Secretary that it has the authority to control the fiscal affairs of the city for the entire period during which assistance under this title will be outstanding;

Independent public accountants, opinions.

(7) the city has agreed—

(A) to obtain and submit to the Secretary, as soon as practicable after the close of each fiscal year of the city during which the Secretary may make guarantees under this title or during which any city indebtedness guaranteed hereunder is outstanding, an opinion of independent public accountants setting forth the results of an audit by such accountants of the financial statements of the city for such fiscal year, which opinion shall describe any deviation in the preparation of such financial statements from generally accepted accounting principles applicable to governmental bodies and shall state that the audit of such financial statements was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as were considered necessary under the circumstances; and

Audit committee. Establishment.

(B) to establish an audit committee which shall assist in the determination of areas of inquiry for, review the progress of, and evaluate the results of, audits to be conducted by such independent public accountants, and which shall consist of the mayor of the city, the comptroller of the city, the president of the city council, two individuals with expertise in municipal finance, and two officers or employees of two different firms of independent public accountants which are not engaged either by the city or by the comptroller of the city, such individuals and such officers or employees of such firms to be selected by the independent fiscal monitor;

(8) (A) in the case of guarantees issued after June 30, 1979, the State has furnished to the Secretary satisfactory assurances that the amount of financial assistance to be provided by the State to the city during the fiscal year in which such guarantee is to be issued will not be less than the amount of such assistance which was provided during the fiscal year ending June 30, 1979, except during any fiscal year for which the city has presented a budget which the Secretary has determined is balanced in accordance with generally accepted accounting principles; and

(B) the State or an agency of the State, subject to and in accordance with applicable State law, when any guarantee hereunder is made by the Secretary, shall deposit in a fund approved by the Secretary, an amount which, together with all amounts

previously so deposited in such fund, shall equal not less than 5 per centum of the principal of and of one year's interest on the then outstanding city indebtedness then guaranteed under this title, and which shall, under the direction of the Secretary, be used to pay, or to reimburse the Treasury for paying, principal and interest which the city fails to pay, the payment of which is guaranteed under this title, but in no case will the fund be used to pay or reimburse an amount in excess of 5 per centum of the principal amount of and of one year's interest on all guaranteed city indebtedness outstanding on the date of the failure;

(9) the city has agreed, in addition to other efforts undertaken by the city to increase employee productivity, to establish a productivity council (A) which shall consist of representatives of the city government and of city employee unions, (B) which shall develop and seek to implement methods for enhancing the productivity of the city's labor force, and (C) which shall have a representative of the independent fiscal monitor as an observer, and the independent fiscal monitor shall review and report, not less than annually, on the development and implementation of such methods, such report to be published and made available to the public, and transmitted to the Secretary;

Information, availability to the public.

(10) the city has agreed to offer to sell for distribution to the public its short-term notes in fiscal years 1980, 1981, and 1982 and its long-term bonds in fiscal years 1981 and 1982, unless the Secretary determines that any such offer would be inconsistent with the financial interests of the city;

(11) the city has agreed that—

(A) following the fiscal year ending June 30, 1982, and during any fiscal year thereafter in which a guarantee under this title is outstanding, the city will pay or provide for the payment of city indebtedness than guaranteed hereunder, giving priority to city indebtedness having the longest maturity or maturities, in a principal amount not less than 15 per centum of the net proceeds of city indebtedness issued in public credit markets during such year, except that the Secretary may modify or waive such 15 per centum requirement to the extent he determines that its application (i) would substantially impair the city's ability to meet its essential capital needs, or (ii) would substantially overburden the market for long-term city indebtedness; and

(B) as soon as practicable after the Secretary determines that the city has demonstrated its ability to meet its long-term credit needs through public credit markets, the city will implement a program satisfactory to the Secretary of refunding any outstanding city indebtedness guaranteed under this title for the purpose of achieving complete repayment of such indebtedness at the earliest practicable date, taking into consideration such factors as the Secretary deems appropriate, including the effect of such refunding on the city's need to maintain the city's continued access to public credit markets for its long-term credit needs; and

(12) the city and the State are meeting their respective obligations under this section.

Any determination by the Secretary that the conditions set forth in this section have been met shall be conclusive, such determination to be evidenced by the making of such guarantee, and the validity of any guarantee so made shall be incontestable in the hands of the holder of

such city indebtedness, except for fraud or material misrepresentation on the part of such holder. The Secretary is authorized to determine the manner in which such guarantees will be issued and, in addition to the terms and conditions required by this section, to require from, or agree to with, the city, a financing agent, the holders of the city indebtedness guaranteed, and any other party in interest such other terms and conditions as he may deem appropriate, including provision of security for the repayment of amounts paid pursuant to any guarantee under this title. Any such other term or condition may be modified, amended, or waived in the discretion of the Secretary.

LIMITATIONS ON GUARANTEE AUTHORITY

31 USC 1524.

SEC. 104. (a) (1) The authority of the Secretary to extend guarantees under this title shall not at any time exceed $1,650,000,000 in the aggregate principal amount outstanding.

(2) During the fiscal year beginning on July 1, 1978, not to exceed $750,000,000 shall be available for the guarantee of city indebtedness—

(A) of which not to exceed $500,000,000 shall be available for the guarantee of city indebtedness maturing more than one year after its date of issuance, and

(B) of which not to exceed $325,000,000 shall be available for the guarantee of city indebtedness maturing in one year or less after its date of issuance, but only to the extent authorized by the provisions of subsection (b).

(3) During the fiscal year beginning on July 1, 1979, not to exceed the sum of—

(A) $250,000,000, and

(B) $750,000,000 reduced by the principal amount of city indebtedness guaranteed prior to July 1, 1979, and outstanding on the date on which the guarantees are made under this paragraph,

shall be available for the guarantee of city indebtedness maturing more than one year after its date of issuance, except that no guarantees may be made under this paragraph if prior to July 1, 1979, either the Senate or the House of Representatives agrees to a resolution stating in substance that it disapproves such guarantees.

(4) During the fiscal year beginning on July 1, 1980, not to exceed the sum of—

(A) $325,000,000, and

(B) $1,000,000,000 reduced by the sum of (i) the principal amount of city indebtedness guaranteed under paragraphs (2) (A) and (3) and outstanding on the date on which the guarantees are made under this paragraph, and (ii) the amount, if any, covered by a resolution agreed to by the Senate or the House of Representatives pursuant to paragraph (3),

shall be available for the guarantee of city indebtedness maturing more than one year after its date of issuance, except that no guarantees may be made under this paragraph if prior to July 1, 1980, either the Senate or the House of Representatives agrees to a resolution stating in substance that it disapproves such guarantees.

(5) During the fiscal year beginning on July 1, 1981, not to exceed the sum of—

(A) $325,000,000, if the Secretary determines, in accordance with generally accepted accounting principles, that the city has presented a balanced budget, and

(B) $1,325,000,000 reduced by the sum of (i) the principal amount of city indebtedness guaranteed under paragraphs (2)(A), (3), and (4) and outstanding on the date on which the guarantees are made under this paragraph, and (ii) the sum of the amounts, if any, covered by resolutions agreed to by the Senate or the House of Representatives pursuant to paragraphs (3) and (4),

shall be available for the guarantee of city indebtedness maturing more than one year after its date of issuance.

(b) The Secretary may guarantee the payment of principal or interest, or both, on city indebtedness issued prior to January 1, 1979, and maturing prior to July 1, 1979, but only to the extent that the Secretary determines, after taking into account any commitments the employee pension funds of the city have made with respect to the purchase of city indebtedness maturing more than one year from its issuance, that the employee pension funds of the city are not able to provide sufficient amounts of seasonal financing as required under section 103(4) of this title without being considered to have failed to meet the requirements of section 401(a) of the Internal Revenue Code of 1954 (as such requirements apply to such pension funds) or being considered to have engaged in a prohibited transaction described in section 503(b) of the Internal Revenue Code of 1954.

26 USC 401.

26 USC 503.

REMEDIES

SEC. 105. (a) The Secretary shall take such action as may be appropriate to enforce any right accruing to the United States or any officer or agency thereof as a result of the issuance of guarantees under this title. Any sums recovered pursuant to this section shall be paid into the general fund of the Treasury.

31 USC 1525.

(b) The Secretary shall be entitled to recover from the borrower, or any other person liable therefor, the amount of any payment made pursuant to any guarantee agreement entered into under this title, and upon making any such payment, the Secretary shall be subrogated to all the rights of the recipient thereof.

(c) Notwithstanding any other provision of law, the Secretary shall provide for the withholding of any payment from the United States to the city or State which may be or may become due pursuant to any law and offset the amount of such withheld payment against any claim the Secretary may have against the city or State pursuant to this title.

(d) The remedies prescribed in this title shall be cumulative and not in limitation of or substitution for any other remedies available to the Secretary or the United States.

(e) With respect to any debt of the United States arising under this title, for the purposes of section 3466 of the Revised Statutes (31 U.S.C. 191), the term "person" includes the city and any financing agent. Notwithstanding the provisions of such section, the Secretary is authorized to waive, wholly or partially, the priority for the United States established thereunder with respect to any indebtedness of the city or the financing agent issued after the effective date of this title (other than any indebtedness the proceeds of which are applied to the repayment prior to the stated maturity thereof of indebtedness outstanding on or before the effective date of this title owed to the lender of such proceeds) if, in his judgment such waiver is necessary to facilitate the ability of the city to meet its financing needs. No waiver under the preceding sentence shall by its terms subordinate the claims of the

"Person."

Waiver.

United States to those of any creditor of the city or any financing agent.

Civil action. Jurisdiction.

(f) The Secretary may bring a civil action in any United States district court or any other appropriate court to enforce compliance with the provisions of this title, any agreement related thereto, or any provision of State law related thereto, by the city, the State, the financing agent, the independent fiscal monitor, or any official of any of the foregoing, or any other party to any such agreement, and such court shall have jurisdiction to enforce such compliance and enter such orders as may be appropriate.

INSPECTION OF DOCUMENTS

31 USC 1526.

SEC. 106. At any time a request for a guarantee is pending or indebtedness guaranteed under this title is outstanding, the Secretary is authorized to inspect and copy all accounts, books, records, memorandums, correspondence, and other documents of the city or any financing agent relating to the city's financial affairs.

GENERAL ACCOUNTING OFFICE AUDITS

31 USC 1527.

SEC. 107. The General Accounting Office is authorized to make such audits as may be deemed appropriate by the Comptroller General of all accounts, books, records, and transactions of the city and any financing agent. No guarantee may be made under this title unless and until the city and any financing agent agree, in writing, to allow the General Accounting Office to make such audits. The General Accounting Office shall report the results of any such audit to the Congress.

Report to Congress.

REPORTS TO CONGRESS

31 USC 1528.

SEC. 108. Within three months after the date of enactment of this title, and at six-month intervals until June 30, 1982, and thereafter at twelve-month intervals, the Secretary shall transmit to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Banking, Finance and Urban Affairs of the House of Representatives a report containing a detailed statement of his activities under this title.

SEVERABILITY

31 USC 1529.

SEC. 109. If any provision of this title is held to be invalid, or the application of such provision to any person or circumstance, is held to be invalid by a court of competent jurisdiction, the remainder of this title, or the application of such provision to persons or circumstances other than those as to which it is held invalid, shall not be affected thereby.

TERMINATION

31 USC 1530.

SEC. 110. The authority of the Secretary to make guarantees under this title terminates on June 30, 1982. Such termination does not affect the carrying out of any contract, guarantee, or other obligation entered into pursuant to this title, or the taking of any action necessary to preserve or protect the interests of the United States arising hereunder, except that no commitment to guarantee the payment of principal or interest on city indebtedness under this title shall be effective after such date.

United States to those of any creditor of the city or any financing agent.

Civil action. Jurisdiction.

(f) The Secretary may bring a civil action in any United States district court or any other appropriate court to enforce compliance with the provisions of this title, any agreement related thereto, or any provision of State law related thereto, by the city, the State, the financing agent, the independent fiscal monitor, or any official of any of the foregoing, or any other party to any such agreement, and such court shall have jurisdiction to enforce such compliance and enter such orders as may be appropriate.

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AUTHORIZATION

SEC. 111. (a) There are authorized to be appropriated beginning October 1, 1978, and to remain available without fiscal year limitation, such sums as may be necessary to carry out this title. 31 USC 1531.

(b) Any other provision of this title to the contrary notwithstanding, the authority of the Secretary to make any guarantee under this title shall be limited to such extent or amounts as are provided in advance in appropriation Acts.

TITLE II—AMENDMENTS TO THE INTERNAL REVENUE CODE OF 1954

SEC. 201. TAXABILITY OF CERTAIN FEDERALLY GUARANTEED OBLIGATIONS.

(a) CERTAIN FEDERALLY GUARANTEED OBLIGATIONS.—Section 103 of the Internal Revenue Code of 1954 (relating to interest on certain governmental obligations) is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (e) the following new subsection: 26 USC 103.

"(f) CERTAIN FEDERALLY GUARANTEED OBLIGATIONS.—Any obligation the payment of interest or principal (or both) of which is guaranteed in whole or in part under title I of the New York City Loan Guarantee Act of 1978 shall, with respect to interest accrued during the period for which such guarantee is in effect, be treated as an obligation not described in subsection (a).".

(b) OBLIGATIONS MAY NOT BE ACQUIRED BY FEDERAL FINANCING BANK.—Nothing in any provision of law shall be construed to authorize the Federal Financing Bank to acquire any obligation the payment of interest or principal of which has at any time been guaranteed in whole or in part under title I of the New York City Loan Guarantee Act of 1978. 12 USC 2285a.

(c) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to taxable years ending after the date of the enactment of this Act. 26 USC 103 note.

Approved August 8, 1978.

LEGISLATIVE HISTORY:

HOUSE REPORTS: No. 95-1129, Pt. 1 (Comm. on Banking, Finance and Urban Affairs), and Pt. 2 (Comm. on Ways and Means); and No. 95-1369 (Comm. of Conference).

SENATE REPORT No. 95-952 (Comm. on Banking, Housing, and Urban Affairs).

CONGRESSIONAL RECORD, Vol. 124 (1978):

June 6-8, considered and passed House.
June 29, considered and passed Senate, amended.
July 25, House agreed to conference report.
July 27, Senate agreed to conference report.

WEEKLY COMPILATION OF PRESIDENTIAL DOCUMENTS, Vol. 14, No. 32:

Aug. 8, Presidential statement.

or contract, such studies, and evaluations as are necessary ve implementation of this Act, National Center for Education provide to the appropriate ach House of the Congress and to c at least annually, programmatic erning programs and projects is Act and other Federal programs ucation of handicapped children. , not later than 120 days after ach fiscal year, the Commissioner the appropriate committees of the Congress a report on the ade toward the provisions of free c education to all handicapped ing a detailed description of all ties conducted.

ants to States which have met the rements of this Act and have an lan, to be used for the provision ion and related services to the three to five. Sets a maximum f $300 per child.

provisions relating to the ayments under this Act to State s, and to local and intermediate ies.

ny proposed changes in the hildren with specific learning be submitted to the Congress. n presently to mean those children der in one or more of the basic rocesses involved in understanding uage, spoken or written, which nifest itself in imperfect ability , speak, read, write, spell, or do culations.

Secretary of Health, Education, assure that each recipient of this Act shall make positive ploy and advance in employment capped individuals in programs his Act.

upon application by any State or onal agency or intermediate , the Commissioner to make grants r all of the cost of altering ngs and equipment to remove rriers.

the Secretary to enter into institutions of higher education, educational agencies, or other nonprofit agencies, for the nd operation of centers on edia and materials for the

rted to Senate from the Committee abor and Public Welfare with dment, S. Rept. 94-168
ure called up by unanimous consent enate
ure considered in Senate
ure passed Senate, amended, roll #227 (83-10)
rred to House Committee on ation and Labor
ure called up by special rule in e
ure considered in House
ure passed House, amended, in lieu .R. 7217
erence scheduled in Senate
erence scheduled in House
erence report filed in House, H. . 94-664
erence report filed in Senate, S. . 94-455
se agreed to conference report under pension of rules, roll call #715 4-7)

11-19-75 Senate agreed to conference report, roll call #513 (87-7)
11-19-75 Measure enrolled in House
11-19-75 Measure enrolled in Senate
11-20-75 Measure presented to President
11-29-75 Public law 94-142

Pub. L. 94-143. Approved 12/9/75; H. R. 10481.

New York City Seasonal Financing Act - Provides that upon written request of the City of New York or a financing agent thereof (authorized by the State of New York), the Secretary of the Treasury may make loans to the city or such agent subject to this Act.

Matures such a loan not later than the last day of the city's fiscal year in which it was made, and sets the interest rate at one percent greater than the current average market yield on United States obligations. Permits the Secretary to require such security as he deems appropriate. Permits him to offset payments due under this Act by withholding other Federal payments to the city.

Limits outstanding loans under this Act at any one time to $2,300,000,000. Prohibits extension of further loans unless the city is in compliance with the terms of past loans.

Establishes the New York City Seasonal Financing Fund in the Treasury and authorizes appropriation of $2,300,000,000 to it. Authorizes the Secretary to inspect records of the city or any financing agent thereof. Prohibits loans under this Act unless the General Accounting Office is authorized to conduct audits of the State, city, and any financing agent thereof.

Terminates the loan authority of this Act on June 30, 1978.

11-06-75 Reported to House from the Committee on Banking, Currency and Housing with amendments, H. Rept. 94-632 (Part I)
11-06-75 Referred to House Committee on Ways and Means
11-13-75 Reported to House from the Committee on Ways and Means with amendments, H. Rept. 94-632 (Part II)
12-02-75 Measure called up by special rule in House
12-02-75 Measure considered in House
12-02-75 Measure passed House, amended, roll call #728 (213-203)
12-03-75 Referred to Senate Committee on Banking, Housing and Urban Affairs
12-03-75 Measure called up by unanimous consent in Senate
12-03-75 Measure considered in Senate
12-03-75 Motion to table motion to refer to Banking, Housing & Urban Affairs Committee passed Sen., r.c.#540(57-23)
12-03-75 Cloture motion filed in Senate
12-04-75 Measure considered in Senate
12-05-75 Cloture motion passed Senate, roll call #553 (70-27)
12-05-75 Measure considered in Senate
12-05-75 Measure passed Senate, roll call #566 (57-30)
12-08-75 Measure enrolled in House
12-08-75 Measure enrolled in Senate
12-08-75 Measure presented to President
12-09-75 Public law 94-143

Pub. L. 94-144. Approved 12/9/75; H. R. 6692.

Authorizes appropriations for the period July 1, 1976, through September 30, 1976, as may be necessary to conduct programs and activities for which funding was authorized on June 30, 1976, provided that this Act shall not affect any other law authorizing appropriations for such period.

6-11-75 Reported to House from the Committee on Government Operations with amendment,

COMMITTEE REPORT ON THE NEW YORK CITY LOAN PROGRAM

On April 1 and 2, 1976, the Senate Committee on Banking, Housing and Urban Affairs held its first oversight hearings on the New York City Seasonal Financing Act.

This law, Public Law 94–143, was enacted on December 9, 1975, in the midst of great controversy. New York City had gone from crisis to crisis since the credit markets closed to it in April 1975. In June, the Municipal Assistance Corporation (MAC) was formed to borrow on behalf of the City and receive certain revenues to cover these borrowings. By August it was apparent that the markets were closing to MAC as well, and the State stepped in. The Emergency Financial Control Board was established, with the Governor as Chairman, and with broad authority to run the City's fiscal and financial affairs, to reject contracts, and to impose a three-year wage freeze. The State law also required the City to draw up and implement a Financial Plan to bring its budget into balance by June 30, 1978. Then in September, State and City officials sought financial assistance from the Federal government.

After long and often contentious deliberations within the Congress and the Administration over the need for Federal financial assistance to New York City, an agreement was worked out by the Administration with New York State and City officials, which included the following points:

- A State passed three-year moratorium on $1.6 billion in short-term City notes coming due, and a reduction in the interest rate to 6 percent;
- More than $200 million in additional City taxes;
- $2.5 billion in loans from the union pension funds over the period of the financial plan, to meet the City's regular borrowing needs;
- $800 million each year in advance aid payments from the State to the City; and
- Up to $2.3 billion a year in Federal loans to cover the City's seasonal financing needs through June 30, 1978.

The New York City Seasonal Financing Act was passed to authorize the Federal loans. It provides that the loans are to be made only if the Secretary of the Treasury determines there is a reasonable prospect of repayment. The loans must be repaid in full at the end of each of the City's fiscal years, with interest at a rate of one percent above the Treasury's cost of borrowing.

A Credit Agreement concluded between the Federal government and the various City and State authorities pursuant to the Act spelled out the terms and conditions of the loans and repayments. It also required regular reports to the Treasury on New York City's financial condition and its progress under the Financial Plan.

In the course of Senate debate on the New York City legislation, the Committee on Banking, Housing and Urban Affairs undertook a firm commitment to conduct continuing oversight of the New York City

financial situation and the progress being made toward fiscal responsibility under the Seasonal Financing program. For the first set of hearings, the Committee saw the need to take a close look at the City's progress and problems. This report details our findings and recommendations, based on testimony given in the hearings and information obtained subsequently.

FINDINGS AND RECOMMENDATIONS

1. Finding.—The Committee finds evidence in reports by the Special Deputy (State) Comptroller that New York City is falling behind schedule in making expenditure reductions required by its Financial Plan, even though the City claims to be meeting its targets and making substitute cuts where necessary. If the City's budget cuts and revenues continue to lag behind its own projections, this will raise serious questions about the City's ability to carry out the Financial Plan and balance its budget by June 30, 1978, when the Federal loan program expires.

Recommendation.—In view of the crucial importance of the execution of the Financial Plan, the Committee recommends that the Treasury, with the assistance of the General Accounting Office, conduct or obtain independent analyses of the City's expenditure reductions and revenue estimates, and that the Treasury further develop its capacity to monitor the City's progress. The Committee understands that the Treasury has now retained the services of Arthur Andersen & Co. to aid in such an effort.

2. Finding.—The Committee finds that more than one-third of the expenditure reductions contained in the Revised Financial Plan proposed by Mayor Beame on March 25, 1976, depend on State or Federal take-over of programs now funded by the City. Since the hearings revealed that the City had obtained no commitments on this from either the State or the Federal government, the Committee believes that the Financial Plan should show a higher degree of realism by including alternative reductions to back up all of the proposed State and Federal assistance. The Department of Housing and Urban Development's recent rejection of the City's request for section 8 housing subsidies to reduce the City's spending for public housing ($30 million in fiscal year 1977 and $55 million in fiscal year 1978) lends support to the Committee's view.

Recommendation.—The Committee recommends that the Secretary of the Treasury, in determining whether or not to provide Federal loans in fiscal year 1977, review carefully the Financial Plan adopted by the City and approved by the Emergency Financial Control Board. Failure to adopt and adhere to a realistic Financial Plan would raise serious doubts about New York City's ability to repay the Federal loans and re-enter the credit markets by fiscal year 1979.

3. Finding.—The Committee finds that maintaining the current three-year wage freeze is vital to the success of the Financial Plan, since the wage base is $4 billion, or one-third of the City's budget. If the cost-of-living increase provided in the tentative agreement with the Transport Workers Union had been approved, and then extended to the municipal employee unions, it could have cost the City about

$375 million more over the life of the Financial Plan. The Committee commends the Control Board for rejecting that agreement but remains concerned that any pay raise granted to the transit workers would set a dangerous precedent for negotiations with the municipal employee unions. Even a minor raise granted to City employees could cost $200 million or more, which would undermine the Financial Plan and cast doubts on the City's ability to repay the Federal loans.

Recommendation: The Committee recommends that if the current three-year wage freeze is not maintained, the Secretary should seriously consider ending the Federal loan program.

4. Finding.—The Committee finds that the fringe benefits New York City provides its employees are far more generous than those of other cities, or of the Federal government or private industry. Cuts in fringe benefits offer the greatest potential for reducing personnel expenditures, both now and in the future. Yet the City is proposing no more than a one percent overall reduction in these benefits.

Recommendation.—The Committee recommends that the Secretary question any Financial Plan which does not include substantial fringe benefit reductions in labor contracts negotiated for the period after June 30, 1976.

5. Finding.—The Committee finds that the rent control program administered under State law is a major cause of the decline of New York City's housing stock and the erosion of its real estate tax base.

Recommendation.—The Committee recommends that the City and State confront this problem squarely and, if necessary, take the actions needed to phase out rent control.

6. Finding.—The Committee finds there is a possibility that New York City may not be able to meet all of its credit needs in the private markets after June 30, 1978. If the City cannot borrow after the Federal loan program expires, it will be faced with the prospect of bankruptcy unless it can meet its credit needs through the State. Governor Carey told the Committee that the New York State Constitution prohibits the State from lending to a municipality.

Recommendation.—Since amending the New York State Constitution takes at least two years, the Committee recommends that State officials give immediate consideration to taking the necessary action to remove any constitutional impediment to meeting the City's credit needs, or else face a potential New York City bankruptcy in 1978.

7. Finding.—The Committee finds that the City will have substantial debt obligations coming due after June 30, 1978, including $941 million in notes currently under moratorium, and that the City has not provided in its plan for an accumulation of funds to repay these obligations. There will also be intense pressure on the City to increase the wages of City employees, to expand capital construction, and to increase other expenditures as well as to reduce taxes.

Recommendation.—The Committee recommends that, in view of the importance of assuring that the City's budget will remain balanced after fiscal year 1978 if it is to regain access to the private credit markets, the Secretary of the Treasury request the City to prepare and submit to him a tentative financial plan for the fiscal years 1979 through 1981.

FOCUS OF THE OVERSIGHT HEARINGS

Even prior to the oversight hearings, the Committee was concerned about developments on the New York City financial scene following passage of the Seasonal Financing Act. A report done for the Treasury by the accounting firm of Arthur Andersen & Co., issued on January 14, raised a number of questions about New York City's Financial Plan and its ability to achieve a balanced budget by June 30, 1978. The Andersen report contended that the City was far behind schedule in making the $200 million in budget cuts required for fiscal year 1976, that its revenues could fall far short of the estimates in the Plan, and that the City's accounting systems were in such bad shape that it was impossible for City budget officials to control expenditures effectively or chart the progress made under the Financial Plan.

While the City denied the existence of some of the problems pointed out in the Andersen report and said that others were being worked out, its first financial report to the Treasury, issued on February 15, showed there was cause for concern. The report revealed an increase of $297 million in the City's projected deficit for the Financial Plan period. The total deficit was estimated to be $1.021 billion, up from the $724 million figure contained in the Financial Plan presented to Congress and the Administration during the debate on the legislation. This meant that in order to achieve a balanced budget by the end of fiscal year 1978, the City would have to cut its budget by $410 million for each of the next two fiscal years—twice the amount of the cuts required for fiscal year 1976 and two-thirds higher than the cuts originally planned for fiscal years 1977 and 1978.

Subsequent reports suggested that Mayor Beame was planning to "backload" most of the budget cuts into the third year of the Financial Plan, in hopes of receiving Federal aid, and that Governor Carey believed a "stretch-out" of the Federal loan program would be needed. Members of the committee expressed their concern that there appeared to be no firm resolve to take the actions needed to balance the City's budget.

Meanwhile, New York City faced the threat of a mass transit strike on April 1, the opening day of the hearings, if negotiations between the State-run Transit Authority and the Transport Workers Union failed to result in a contract agreement by that date. The outcome of these negotiations was seen as crucial to the City's ability to maintain the three-year wage freeze, a major element of the Financial Plan.

In the oversight hearings, the Committee's attention focused on three main areas of concern.

1. Protection of the Federal interest. Will New York City be able to repay the Federal loans provided under the Act by the end of its fiscal year, June 30, 1976, as required by the law? Looking ahead, will the City be able to show a reasonable prospect of repayment of Federal loans in the two succeeding fiscal years, in order to qualify for continued financial assistance under the Act?

2. Prospects for New York City's balancing its budget by June 30, 1978. Will the City, under the aegis of the Emergency Financial Control Board, take the actions necessary to reduce expenditures and arrive at a balanced budget by the end of its 1978 fiscal year, when the

Federal loan program expires? Is the City on schedule with respect to budget reductions required in fiscal year 1976? Have City officials developed a realistic and workable Financial Plan for making the necessary budget cuts in the next two fiscal years?

3. Prospects for the City's re-entering the credit markets after June 30, 1978. Will the City be able to regain investor confidence and meet all its borrowing needs in the private markets without Federal assistance from fiscal year 1979 onward?

Members of the Committee explored these questions at length in the course of the two days of oversight hearings. The following persons appeared as witnesses at the hearings:

William E. Simon, Secretary of the Treasury, who is charged with administering the New York City Seasonal Financing Act.

Hugh L. Carey, Governor of the State of New York and Chairman of the Emergency Financial Control Board.

Abraham D. Beame, Mayor of the City of New York.

Sidney Schwartz, Special Deputy (State) Comptroller for the City of New York, who performs the audit function for the Emergency Financial Control Board.

Elmer B. Staats, Comptroller General of the United States, General Accounting Office, who is authorized under the Act to make such audits as may be deemed appropriate and report the results to the Secretary of the Treasury and to the Congress.

Joel W. Harnett, Chairman, and Burton H. Marks, President, The City Club of New York, a non-partisan civic association which monitors the performance of the City government.

The remainder of this report describes the information obtained in the oversight hearings and the Committee's recommendations based on that information.

PROTECTION OF THE FEDERAL INTEREST

The Committee is reasonably confident at this point that Federal loans in this fiscal year will be paid back in full by June 30, 1976. In his prepared statement, Secretary Simon said he was "satisfied that there exists a reasonable prospect that the entire $1.26 billion will be repaid." He announced the schedule of repayments: $270 million on April 20, $240 million on May 20, $250 million on June 20, and $500 million on June 30. Mayor Beame identified $1.94 billion in City revenues pledged for repayment of the loans, most of which are anticipated State assistance payments. Governor Carey assured the Committee that New York State would be able to borrow the funds it needed in the private credit markets in order to make those assistance payments to the City.

New York State began its spring borrowing effort on April 15 as scheduled, and New York City then made its first repayment to the Treasury slightly ahead of time—on April 6. There appears to be no reason to doubt that the other fiscal year 1976 repayments will be made in timely fashion.

However, apparent changes in the repayment schedule give some cause for concern about the true size of the City's deficit. According to a schedule circulated by the Treasury to the Appropriations Committee last December, there were supposed to be $941 million in

loans outstanding in April, $596 million in May, and none by the end of June. Under the present schedule, there will still be $750 million in Federal loans outstanding, about 60 percent of the total, as late as June 20, and $500 million will not be repaid until June 30, the very last day of the fiscal year.

The Committee remains concerned that the City intends to borrow back on July 2 at least the $500 million it repaid on June 30, and perhaps as much as $1 billion! While the planned repayment meets the letter of the law, the Committee is not convinced that a one-day hiatus followed by a new loan of $500 million or more represents a true seasonal financing program. It appears the City may have patterned its cash flow so that it has a constant need for a revolving seasonal credit of from $500 million to $1 billion, which raises disturbing questions about its re-entry into the credit markets after June 30, 1978.

The Committee urges the Secretary to examine closely the City's July loan request and the reasons underlying the need for a large infusion of Federal cash at that time. It would seem advisable that the Secretary act to minimize the Federal government's financial exposure at this early point in the fiscal year. Looking toward the longer term, the City and State should take steps toward revising the City's revenue collection schedule and smoothing out some of the seasonal shortfalls. This would in turn reduce the City's borrowing needs and the attendant interest costs.

These questions should continue to enter into the Secretary of the Treasury's deliberations over whether or not to provide the July 2 loan and subsequent loans in the 1977 fiscal year. The law requires that the Secretary determine there is a "reasonable prospect of repayment" before he makes a loan to the City. The question of whether or not the City's need for the loan is genuinely due to seasonal shortfalls should continue to bear on that determination.

PROSPECTS FOR A BALANCED BUDGET BY JUNE 30, 1978

The achievement of a balanced budget by June 30, 1978, depends crucially on New York City's adopting and adhering to a workable Financial Plan. If the City does not do this, it will raise serious doubts about its ability to repay the Federal loans and re-enter the credit markets by fiscal year 1979. Therefore, the Committee urges the Secretary to continue to give detailed consideration to the proposed Financial Plan in making his determination of a reasonable prospect of repayment of the fiscal year 1977 Federal loans.

On March 25, 1976, Mayor Beame announced a revised Financial Plan to close the budget gap in fiscal years 1977 and 1978. This is the first detailed revision since the original Financial Plan was drawn up and presented in October, 1975. Under the new Plan, the City would cut its spending by a total of $862 million—$379 million in fiscal year 1977 and $483 million in fiscal year 1978. Added to the $200 million in annualized cuts planned to be achieved in this fiscal year, the combined budget cuts would be sufficient to wipe out the present deficit, now calculated at $1.051 billion, and to come out with a small surplus.

The Committee commends the Mayor for coming up with a concrete plan for balancing the budget and for doing this ahead of the April 15 budget submission deadline and in advance of the Committee's hearings. We know that drawing up the Plan required many hard

decisions to cut more and more out of a budget that has already been slashed. Mayor Beame listed in his statement some of the actions the City has taken to date: reduced employment by about 45,000 people since January 1975—a decrease of 15 percent; instituted larger school class sizes; cut back on trash collections; eliminated 40 fire companies, and so on.

Nonetheless, the Committee continues to hear disquieting rumors that not everyone takes the three-year plan seriously, that there is a feeling among City officials that after the November elections there will be more easy money flowing and the City will ask for and get an extension of the Federal loan program and a stretch-out of the budget cuts.

The Committee takes the three-year Financial Plan quite seriously, and it would be sheer folly for anyone to assume that the Committee would support an extension of the Federal loan program beyond the June 30, 1978 expiration date. Secretary Simon stated that the thought of asking for an extension never even entered his mind. Such a move has no support in the Committee, and as this report indicates, it is the Committee's view that serious deviations from the Financial Plan would be grounds for the Secretary of the Treasury to terminate any further loans to the City under the Seasonal Financing Act.

The Committee's oversight hearings revealed serious questions about the City's progress to date, about the feasibility of the recently proposed Financial Plan, and about the City's ability to avoid certain pitfalls looming ahead which could seriously jeopardize the success of the Plan, such as a new labor contract which would undermine the three-year wage freeze.

A. Progress of the fiscal year 1976 budget reductions

The new Financial Plan assumes that the $200 million in annualized budget savings required for fiscal year 1976 will be achieved. Mayor Beame testified to that effect and added that the City is presently 94 percent on target.

However, both the Comptroller General, Mr. Staats, and the Special Deputy (State) Comptroller, Mr. Schwartz, questioned the accuracy of the City's claims. In a report submitted to the Emergency Financial Control Board covering the period through January 31, 1976, Mr. Schwartz contended that only 39 percent of the planned reductions were on target, while the City maintained it was 82 percent on target.

When questioned about this discrepancy, City officials claimed that they counted the savings differently and, furthermore, that other actions were substituted where slippage occurred. Mr. Schwartz responded at a later point in the hearing that he had been told the substitute cuts would be on target by the fiscal year's end but that the figures were not yet ready for review.

Since the Committee's hearings, the controversy over the progress of the budget cuts has grown, not diminished. In separate reports released on April 28, Mr. Schwartz contended that the City was anywhere from 20 to 64 percent behind (depending on the program) in meeting its expenditure reduction goals, while the City said it was virtually on target. Specifically, City Budget Director Kummerfeld said there had been only a 6 percent lag, amounting to $16 million, and that had been made up through substitute cuts.

In view of the crucial importance of the execution of the Financial Plan, the Committee believes that the Treasury, with the assistance of the General Accounting Office, should conduct or obtain independent analyses of the City's expenditure reductions and revenue estimates. The Secretary ought to have such an analysis available before deciding whether or not to provide Federal loans in the coming fiscal year. We understand from subsequent conversations with Treasury officials that the accounting firm of Arthur Andersen and Co. has been retained for this purpose. Nonetheless, the Committee urges the Treasury to develop its own monitoring capacity as well, given the crucial importance of the execution of the Financial Plan. The General Accounting Office should aid in this effort and should also be in a position to provide the Congress its own independent evaluation of the City's efforts.

The poor quality of New York City's financial accounting system, noted by many observers, casts doubts on the accuracy of the City's claimed budget reductions, and also on its ability to plan and carry out future expenditure cuts. The GAO testimony pointed out that the City's policy has been to account for expenditures on a cash basis, i.e. when they were made and not when incurred, and to account for revenues on an accrual basis, whether they were received or not. This is the exact opposite of accepted accounting practices. Furthermore, the City has had no effective system for controlling expenditures at the time they are made or for ensuring that agencies stay within their budget ceilings.

Section 6.7 of the Credit Agreement between the Treasury and the various City and State authorities requires the City to establish an adequate accounting system by July 1, 1977. The GAO witnesses expressed serious doubts as to whether the City could even meet that far-off deadline, given the present chaotic state of its accounts and the magnitude of the effort required to straighten them out.

The Committee urges both the Treasury and the GAO to continue pressing the City to reform its accounting system as rapidly as possible, and to institute interim improvements in order to provide the most accurate and complete information available. The Committee understands from testimony it has received that a full-scale audit of the City's financial condition cannot be done until the accounting system is reformed. Regular and complete audits are an essential element in restoring the City's credit rating. Therefore, implementation of the new accounting system is urgently needed if the City is to seek private credit after fiscal year 1978.

B. Weaknesses in the proposed financial plan for fiscal years 1977 and 1978

While some of the projected expenditure cuts are questionable, the most glaring weakness of the proposed Financial Plan lies in its reliance on the assumption that the State and Federal Governments will take over certain functions now funded by the City, in order to achieve the required reductions in the City's budget.

Of the $379 million in budget cuts planned for fiscal year 1977, $54 million, or 14 percent, depend on State or Federal action. For the next year, the percentage jumps dramatically. Of the $483 million additional cuts planned in fiscal year 1978, $241 million, or 50 percent, require Federal or State funding to maintain functions now performed by the City.

The State is asked to carry the major share of the load. Under the revised Financial Plan, the State would assume the funding of the courts, probation and corrections systems, and also of the City University system, at a phased-in cost of $24 million in 1977 and $240 million in 1978.

However, when Governor Carey was questioned in the Committee hearings about the City's plans, he was quite discouraging. He said that New York State was "not in a position to become host to any spending programs or absorb programs from other levels of government." While stating that there would be discussions on the proposals with the Legislature, the Mayor, and the panels working on the transition, Governor Carey said none of the requested transfers were going to happen "overnight."

The Committee does not dispute the City's right to request the State to take over some programs, in view of the City's financial plight. Nonetheless, we feel obligated to point out that these assumptions in the Financial Plan are questionable and that the State has not yet made any commitment to pick up the programs the City wants transferred.

The City has proposed alternative reductions in case the State Legislature does not take the necessary actions. The alternative reductions amount to $24 million in fiscal year 1977 and $127 million in fiscal year 1978. While these cuts would make up for a failure of the State to take over the courts, probation and corrections systems, they would not touch the funding needs of the City University system.

Doubts also arose in the Committee's mind regarding the proposed Federal role in reducing the City's budget outlays. According to the revised Plan, the major portion of the 70,300 units in the State and City public housing programs would be transferred to the Department of Housing and Urban Development's section 8 rental subsidy program, under either the provisions for rehabilitated housing or for existing housing. The savings to the City were projected at $15 million for fiscal year 1977 and $40 million for fiscal year 1978, and eventually the City envisioned HUD's taking over the whole program, at an annual cost of $250 million. In addition, the City planned to put the rent increase exemption program for senior citizens under section 8, for a savings of $15 million in each of the next two fiscal years. While the Financial Plan document admitted that some of these actions might not even be permissible under existing HUD regulations, it exuded a blithe confidence that these administrative barriers could be overcome—in time to save the City $85 million over the next two fiscal years.

When HUD Secretary Hills was questioned about this part of the New York City Plan in an appropriations hearing, neither she nor her staff knew anything about the proposal. After further consultations, the Secretary reported to the Appropriations Subcommittee the next day that apparently no New York City officials had even approached the Department of Housing and Urban Development about the feasibility of this massive transfer of housing subsidy programs. Then on May 6, HUD rejected the City's request for the section 8 subsidies, thus confirming the Committee's doubts.

The Emergency Financial Control Board is studying the revised Financial Plan submitted by the Mayor and is scheduled to report its findings in early May. The Board is authorized to approve the Plan

and to require any changes it deems necessary before giving that approval. Since the Governor is also Chairman of the Control Board, he should play a crucial role in deciding the likelihood of the City's achieving the projected cuts.

The Committee urges the Treasury to follow closely the deliberations of the Board, and to do any independent analyses it feels are needed. If the Financial Plan is not workable, because it relies on State and Federal actions that will not be forthcoming, then the Secretary should insist that on the City and the Control Board adopt a realistic Plan. If they still do not do so, this ought to be grounds for cutting off the Federal loans.

C. Pitfalls threatening the success of the financial plan

Even if New York City comes up with a viable Financial Plan, there are many pitfalls lying in the City's path which threaten the success of any plan, however well designed.

Threats to maintaining the three-year wage freeze.—The Committee's most immediate concern is with the three-year wage freeze declared by the Control Board, which is a crucial element in the Financial Plan. Since the City's wage base is around $4 billion or one-third of its budget, even a small wage increase, say 5 percent, would wipe out all of the $200 million in cuts scheduled to be achieved in fiscal year 1976, and might scuttle the Financial Plan as well. The contracts of all the City employee unions and the so-called "covered agencies" independent of the Mayor's control (Board of Education, Health and Hospital Corporation) expire this year, except for the teachers union which has been working without a contract since last year.

Traditionally the transit workers settlement has been the bellwether for the City employee contract negotiations, even though the Transit Authority is a State agency and not under the Mayor's control. Since the transit workers contract expires on March 31, while the City labor contracts end on June 30, the earlier transit settlement has generally been used as a benchmark by the municipal employee unions.

The Transit Authority reached a tentative agreement with the Transport Workers Union at 4:00 a.m. on April 1, thus staving off a mass transit strike due to begin at 6:00 a.m. That agreement, which contained a cost-of-living increase, was turned over for review by the Emergency Financial Control Board, which is authorized to reject any contracts not in compliance with the Financial Plan.

The cost-of-living increase provided in the tentative agreement raised disturbing questions. First, the additional funds to cover it were supposed to come from "productivity increases," but these were not defined in the agreement and there was no indication of how productivity increases would eliminate the need to spend more money, in the absence of substantial attrition or lay-offs.

Second, and more importantly, the agreement would have changed the formula for cost-of-living increases from 1¢ for every 0.4 percent rise in the cost-of-living index to 1¢ for every 0.3 percent rise. While this may sound small to begin with, it turns out to be enormously costly over time. It means that every worker potentially would get a dollar's worth of cost-of-living increase where he once got 76¢, which comes out to a 33⅓ percent increase in future costs. This is precisely the sort of generosity that got the City in trouble to begin with.

Estimates prepared by the City's budget office showed that this settlement, if approved, would have cost the Transit Authority $71.3 million more in payroll spending. If the cost-of-living increase and formula change were then extended to the City unions—and pressures to do so would have been immense—then the cost to the City would have been about $375 million over the life of the Financial Plan, with $94 million of that attributable to the formula change alone.

Both Mayor Beame and Governor Carey told the Committee flatly that the City would not provide any more subsidies to the Transit Authority for pay increases beyond the $183 million in subsidies contained in the Financial Plan. The Transit Authority does, of course, have the ability to raise fares in order to pay for the increase, although the Mayor pointed out that this would have a number of adverse repercussions on the City's residents and its economy.

However, other unions cannot fall back on such a revenue-raising option. Thus, the spill-over effect of a transit workers pay raise on the other employee unions would have severe consequences for the City's Financial Plan, even if there were no immediate expenditure impact.

Recent developments raise hope that State and City officials will stand firm on this vital issue. First, the Control Board referred the transit workers agreement to State Attorney General Lefkowitz for a legal opinion. He ruled that the cost-of-living raise in the tentative agreement did constitute a wage increase and thus violated the State's wage-freeze law. Then Governor Carey announced on April 30 that the Control Board had rejected the contract and instructed the Transit Authority to negotiate and submit a new contract by May 15. The Governor held the door open for some increase in pay, but said it would have to be more clearly tied to worker productivity.

The Committee commends the Control Board for rejecting this key contract and believes this action shows a real determination to set New York City's financial affairs in order. Nonetheless, it is obvious that the pressures to give ground will be great from here on, and whether the City and the Control Board will be able to withstand these pressures remains an open question.

If no new agreement is reached with the transit workers, there will be a mass transit strike beginning on July 1, just before the Democratic National Convention opens at Madison Square Garden.

During that same time period, the difficult negotiations with the City employee unions will be taking place, and there is considerable doubt that the City can get agreement by June 30 on new contracts that comply with the Financial Plan. This raises the threat of more strikes in early July.

In the past, the City has been willing to pay a high price for labor peace. That is one of the root causes of its present financial distress.

The Committee believes the City and State must stand firm. A pay raise to the transit workers would set a dangerous precedent for the City's labor negotiations. Judging from the figures cited previously, any increase approved and then extended to all City employees would cost a minimum of $200 million over the next two years. Thus even a minor raise could undermine the Financial Plan and cast doubts on the City's ability to repay the Federal loans. Under these circumstances, the Secretary should seriously consider ending the loan program.

Reducing fringe benefits.—Although the wage question is important in itself, it is inextricably linked to the question of fringe benefits, and this is an area which offers considerable potential for improving New York City's financial prospects. While a Congressional Budget Office study has shown that New York City's salaries are not way out of line with those of other major cities, there is strong evidence that its fringe benefits far exceed those of other municipalities, or of the Federal government or private enterprise.

Secretary Simon's testimony went into the fringe benefit problem in some detail and revealed some astonishing figures. In the current fiscal year, the bill for City employee fringe benefits—pensions, health insurance, vacations, etc.—will come to over $2 billion, half the total payroll. The cost of these benefits averages out to more than $8,600 per employee, and this figure alone is higher than the average income per person throughout the country. Even if vacations are not counted, fringe and retirement benefits for City workers range from 34 percent to as high as 51 percent of base pay, while the national average is less than 20 percent.

The Committee believes that this area of employee fringe benefits offers the best opportunity for New York City to get out from under the costly contract settlements of the past and to reduce the ruinous burden of escalating labor costs. The Committee is not suggesting that New York City employees should be disadvantaged relative to other workers, whether in the public or private sector. But at the present time, many City employees are incredibly privileged compared to other workers. Those who receive inordinate fringe benefits should bear some of the costs of the City's forced financial retrenchment.

The following chart, taken from the Secretary's testimony, shows the current costs of certain key fringe benefits:

	Millions
Pension	$1,165
Social Security	214
Health and hospitalization insurance	170
Union welfare funds	107
Union annuity funds	36
Uniform allowances	19
Training funds	1
Total	$1,712

Pensions and Social Security make up the largest item. The City has announced its intention to withdraw from the Social Security System, effective as of March 1978. However, it is evident from the above that Social Security contributions are the smallest piece of the pie. While a long-time worker should be entitled to a reasonable pension, the City's method of computing pensions goes beyond the bounds of strict reason, just as the retirement income often goes beyond the take-home pay the worker received in his last year on the job. In an example cited by the Secretary, a married New York City employee who retires at age 65, with 25 years of service, receives a pension equal to 125 percent of his disposable income in the last year of his employment. Comparable figures for other cities are Atlanta, 43 percent; Chicago, 47 percent; Dallas, 52 percent; Los Angeles and Memphis, 54 percent. Only Denver and Detroit even come close to New York City's level of generosity—91 and 104 percent, respectively.

Mayor Beame told the Committee that the New York State Constitution prohibits reductions in the level of pension benefits. Even if the Mayor is correct, there is much that can be done to amend State law and reduce the City's future pension burden, including such things as restoring the requirement of employee contributions—a step already taken in part—and changing the method of computing pension entitlement.

On top of the regular pension benefits, the City also pays $36 million a year into Union Annuity Funds, which in turn provide still more retirement benefits for certain employee groups.

Health benefits is another expensive item. New York City pays 100 percent of employee health insurance, to the tune of $170 million a year. That is far more generous than most cities, certainly more generous than the Federal government—and even this is not the end of the health benefits provided. The City also feeds $107 million a year into something called union welfare funds, which then allows the unions to provide their members, whether active or retired, with still more benefits: free dental care, eyeglasses, counseling and legal services. To top it off, some employees, such as firemen, get unlimited sick leave, which is an open invitation to waste and abuse.

One final item deserves mention. The City pays out $19 million a year in uniform allowances, much of which goes to employees who are not required to wear uniforms. From the sublime to the ridiculous is but a short step.

Mayor Beame has proposed a reduction of $24 million in fringe benefits in his revised Financial Plan. That is just barely more than one percent of the total, while basic services such as higher education and health are being cut 13 and 14 percent. The Mayor claims that no cuts in pensions are possible, that everyone should be entitled to free health care, and that all unions have welfare funds.

The Committee remains highly skeptical and urges the Mayor and the Control Board to work for far larger cuts in City workers' overly generous fringe benefits. Without substantial cuts in fringe benefits in labor contracts covering the period after June 30, certainly more than one percent, the Committee doubts that a credible Financial Plan can be developed, and this is essential for continuing the Federal loan program.

Given the continuing pressure for take-home pay increases, there is only one way the City can keep its budget in balance, and that is to cut back on fringe benefits. It can be done—by reducing the levels of benefits, by changing the method of computing benefits, by increasing employee contributions, or by other means. This is one type of budget savings that can mean something now and a lot more in the future.

Pressures for additional spending.—Other pitfalls in the way of the Financial Plan deserve brief mention. There are and will continue to be intense pressures on City officials to rescind cuts and allow additional spending here and there. The City University is an outstanding example. For weeks the administrators refused to decide where they would make the cuts the City said had to be made. Lengthy debates and spirited street demonstrations were all that resulted. Finally, the Mayor simply, and wisely, put the University on a rationing program and said that whenever the money was gone, be it June 30 or May 1, there would be no more. Presumably this will work, but it

is hardly a model of sound planning and cooperation. The Mayor's action does appear to have accelerated negotiations between the City University and the State on the issues of tuition and State aid.

A more troublesome development, completely beyond the Mayor's control, is the passage of the Stavisky bill by the State Legislature over the Governor's veto. This measure requires the State's municipalities to continue spending for education at the same level as in previous years. Mayor Beame claims that if the City is forced to implement the Stavisky law, it will have to spend $147.9 million more a year for education than the Financial Plan projects. He has announced cuts that could be made to offset this additional education spending, including lay-offs of 5000 more municipal employees, but he has said he intends first to challenge the law in the State courts if the Board of Education presses to get the funding increase. Since the Mayor made that announcement, the Board has formally requested $157 million more in fiscal year 1976 funding than is provided in the Mayor's budget and has claimed that $121 million of that amount is needed to bring the budget into compliance with the Stavisky bill. Board officials have stated they will sue the City if the additional funds are not forthcoming. If the City loses the suit, this will obviously have serious implications for carrying out the Financial Plan.

The problem of rent control.—Rent control is another area of great concern and great political sensitivity. Secretary Simon pointed to the erosion of the City's real estate tax base and cited rent control as the major cause of the "aging, decay and decline of New York's housing stock." The figures are compelling. Since 1960, 300,000 rental units have been abandoned, and abandonments are currently running at a rate of 30,000 units a year. In the last ten years, the City's housing stock increased only 2 percent. And interestingly enough, there is no evidence to show that rent control benefits the poor. Quite the contrary, it helps a small, privileged group of long-time residents, largely middle class, while driving up rents in uncontrolled units.

There is no doubt that rent control is a highly emotional and political issue. Indeed, members of the New York Congressional delegation while pleading for Federal assistance to the City last December, threatened to vote against any bill that would threaten rent control. Mayor Beame sidestepped the issue at the Committee's hearings, while Governor Carey, admitting the problem, ended on this rueful note: "Frankly, it is an election year, and we have more tenants than landlords in the Senate."

The Committee cannot view with complacency the continuing decline in the City's real estate tax collections, which mirrors the decline of its housing stock. Whatever the political costs, the State Legislature will have to confront the rent control problem, and the City should rest its case on the broader economic issues, not the narrowly political ones.

The gloomy economic outlook.—The final pitfall, the most troublesome of them all, is New York City's economic situation, now and in the foreseeable future. Governor Carey spoke grimly of the "factors which are undermining, frankly, the structure and the hopes and the future of the City." These include an unemployment rate of 12.2 percent, the loss of 141,000 private sector jobs in the last year alone, the

increase in welfare costs, the loss of construction jobs due to cuts in the capital budget, and the undeniable fact that New York City is lagging behind the rest of the country in terms of economic recovery. The GAO witnesses also emphasized the economic problem and spoke of the need for the City to institute long-range economic forecasting.

The Municipal Assistance Corporation has been delegated the task of studying and proposing measures to aid the City's economic development, including changes in tax laws which discourage business investment. The Committee realizes that economic recovery is crucial to the City's regaining financial health and urges the Treasury Department to aid the City in its effort to fashion a sound economic development program.

PROSPECTS FOR RE-ENTERING THE CREDIT MARKETS AFTER JUNE 30, 1978

The last remaining question, and ultimately the most important, is whether New York City will be able to get off the Federal dole and back into the private credit markets by July 1, 1978, when the Seasonal Financing Act expires. That depends not only on the City's balancing its budget, a very difficult task, as has been shown, but also on its regaining investor confidence, which is much harder to gauge.

Secretary Simon expressed "cautious optimism" about the City's prospects. He indicated that if he were a private lender, he would look favorably on a city which had successfully weathered a severe financial crisis, acted firmly over 30 months to wipe out a $1 billion budget deficit and correct a decade of financial neglect, and had developed first rate financial accounting and management systems.

The Committee is more skeptical. Comptroller General Staats described the magnitude of the problems facing the City even if it completes the Financial Plan and survives to June 30, 1978:

- $941 million in publicly held notes under moratorium coming due in November 1978, and another $1 billion in institutionally held debt coming due in installments between 1978 and 1986.[1]
- Strong pressure for catch-up wage increases when the three-year freeze ends, if it is successfully maintained; plus the problem of losing good employees during the period of the freeze.
- The problem of having $555 million in operating expenses still included in the capital budget.

All of these are factors which will put enormous strain on the City's budget immediately after it comes through the rigors of the three-year Financial Plan. If the budget is in balance at that point, and State law requires that it be so, it will be very hard to maintain that balance, especially if there is no significant increase in revenues. The Committee is concerned that these factors could make newly issued New York City obligations unattractive to investors. New York State has encountered unusual difficulty in marketing its obligations this year, despite a balanced budget, a history of high bond ratings, and no tradition of financial gimmickry. The State's problems have stemmed largely, though not wholly, from its association with the City's financial problems. If New York State finds it hard to escape those associations, how can New York City escape its own history?

[1] There is reason to beliver that the Municipal Assistance Corporation will at some point offer a new exchange for the notes under moratorium, at a more favorable interest rate, which could reduce substantially the amount of notes coming due in November 1978.

Because of the problems that will be facing New York City at the end of the Financial Plan period, the Committee believes it is essential that the Treasury insist on compliance with section 6.11 of the Credit Agreement which requires the City to use its best efforts on and after July 1, 1977, to meet its seasonal borrowing needs without resort to the Federal loans. Such efforts in fiscal year 1977 could well be a crucial test of the City's ability to re-enter the markets when the loan period ends. If the City tries to do this "cold turkey," after the Federal loans have been cut off, it may well fall flat on its face, with disastrous consequences.

There is a need for cold, clear realism on New York City's financial prospects, and it is the Committee's responsibility to raise the tough questions. The fact is that the City may not be able to borrow after the Federal loan program ends, and there is no disposition on the part of the Committee to extend the loan program.

Therefore, the State and the City should be working together to make contingency plans for the post-1978 period. New York State should be in sound financial shape at that point, while the City may need more time before it can meet all of its credit needs in the private market. During that transitional period, the State should be in a position to step in and lend the City the money it needs to keep operating beyond June 30, 1978.

Governor Carey testified that the New York State Constitution currently prohibits loans to a municipality. If his interpretation is correct, the Committee believes that State officials should give immediate consideration to amending their Constitution to remove this prohibition, since it takes at least two years to complete the amendment process. Otherwise, they will face a potential New York City bankruptcy in the latter part of 1978.

ADDITIONAL VIEWS OF MR. GARN

This first set of oversight hearings has been most revealing for we have been clearly shown that New York City is not complying with its obligations under the 3-year financial plan. The city is behind schedule and its estimated revenues and expenditures have been entirely unrealistic. As the economic conditions of the city and the region fail to keep pace with the national rate of economic growth, the outlook for the city's financial survival is grim. It is a formidable task to contend with external economic factors beyond a city's control in the best of prosperous years, but New York City is too crippled by its own plight to withstand the external economic forces which are further eroding the city's tax base.

Whatever skepticism there was prior to oversight hearings was quickened by the testimony presented before the committee. The Comptroller General of the United States testified that in his expert opinion the 3-year financial plan has lost its usefulness. Far too many problems go unresolved and will remain so for a lack of determination and commitment to achieve fiscal reform for the city.

We don't doubt that New York City will repay its Federal loans due in June. But, in light of the testimony heard before the committee and the continual developments in New York's financial crisis, we do not understand nor agree with the "cautious optimism" of Secretary Simon that the city will be in a position to repay its loans on time in the second and third years of the plan. We are especially troubled with the illusion of loan repayment when in fact it is merely a roll-over of the seasonal debt with a 2-day gap. Thus, in this regard, the financial plan is faulty and misleading inasmuch as it is designed to treat a cash flow problem when New York City's is a cash deficit problem.

We fear that New York City officials will eventually request an extension of the 3-year loan plan. We firmly support Chairman Proxmire's opening remarks in the oversight hearings warning New York City officials that under no circumstances will the committee approve such an extension at any time. There is no question that vitally needed budget cuts and measures are being delayed and put off in hopes of a more sympathetic Congress and White House after the 1976 elections.

Secretary Simon should exert greater pressure on New York City officials to demonstrate their accountability by withholding seasonal loans until the necessary steps have been taken to cut expenditures according to plan.

The committee should hold oversight hearings again after the June 30 loan repayment deadline to assess the city's compliance with the plan. If it is found that the prospects for future loan repayments are just as bleak as they appear now, steps should be taken to allow the inevitable: the bankruptcy of New York City. At least then the city would no longer be running up its ever-increasing cost of debt service.

JAKE GARN.

ADDITIONAL VIEWS OF MR. HELMS

For the most part, the Committee's Report on the New York City Loan Program is an excellent and realistic summary of the current situation. I also believe that Senator Garn's additional views add further valuable insight into the problem.

Unfortunately, however, the very frank appraisal of the Committee Report tends to confirm my worst fears. Indeed, there is nothing in the Report that would give any objective observer any encouragement that New York City will be able to survive bankruptcy (by whatever name it is eventually called). Both the Federal bail-out plan, and the City's Financial plan which is supposed to make the bail-out work, are erected upon a foundation of premises and assumptions, none of which is very realistic.

I am more convinced than ever that it was a serious mistake to take the bail-out route, for we are only forestalling the inevitable. While we put off the day of reckoning, we are simply adding to New York City's problems, by allowing the City's enormous debt to accumulate still further. We are also doing a disservice to the country. By postponing the exposure of the end result of the "tax and tax, borrow and borrow, spend and spend" syndrome, we are denying the country the public awareness necessary to put its own house in order before it suffers the fate of New York City.

As has often been remarked, and as Secretary Simon agreed in response to one of my questions during these oversight hearings, the only difference between New York City and the Federal Government is a printing press. The Federal Government can print money, and commit legalized larceny against future generations. Both the City of New York and the Federal Government ought to face up to their respective irresponsibility of the past—before it is too late.

JESSE HELMS.

C.L

Statement by

J. Charles Partee

Managing Director for Research and Economic Policy,

Board of Governors of the Federal Reserve System

before the

Subcommittee on Commerce, Consumer and Monetary Affairs

of the

Committee on Government Operations

U. S. Congress

October 8, 1975

I am glad to appear before this Committee today to describe briefly the program of analysis that has been carried on by the Federal Reserve staff in order to keep the Board informed of developments and implications of the New York City financial situation. A great deal of work of the kinds I will be describing has been done at the Federal Reserve Bank of New York as well as at the Federal Reserve Board.

As the New York City financial crisis began to deepen this past spring, following shortly upon the temporary default by the Urban Development Corporation -- a so-called "moral obligation" agency of New York State -- it became clear to us that there might be four separate areas of possible involvement by the Federal Reserve System for which background analysis or contingency planning would be needed.

First, it seemed conceivable that the Federal Reserve would be approached by the City with an application for emergency credit assistance. Efforts were made, both at the Federal Reserve Bank and at the Board, to assess the basic financial position of New York City, in order to be prepared for such an eventuality. Governor Mitchell has already testified before this Committee, on June 25, as to the considerations the Board would have had to take into account if it were to consider the use of our existing authority in support of the City.

Our second concern was for the possible implications of a New York City default on the behavior of the financial markets and the performance of the economy generally. In this regard, I should point out that there is little historical precedent to go on in evaluating the

probable repercussions of a failure of this magnitude, other than for the events surrounding the Penn-Central bankruptcy in the spring of 1970. Nevertheless, we have been following developments in the municipal securities market and in State and local employment and spending trends with unusual care, and we have attempted at every opportunity to probe investor sentiment as to current and prospective New York City developments, both in the United States and abroad. Until very recently, when New York State and various other governmental units have been caught up in widening investor concerns, the staff view generally has been that a New York City default would not be likely to have significant national repercussions, though its financial and economic effects in the New York area could of course be substantial.

Third, the Federal Reserve necessarily would be concerned with any failure of financial markets to function because of its role as the ultimate source of liquidity to the economy. In the event of a major default, financial flows could well become distorted for a time. Some commercial banks might suffer deposit outflows or have unusual needs for liquidity. Some municipalities might find it impossible to carry on planned financings in the market, and could find themselves in a temporary liquidity squeeze. Similarly, participants in the municipal market -- both investors and dealers -- might be unable to liquidate positions as planned, and could find themselves in necessitous need of temporary credit accommodation. Our contingency plans for use of the Federal Reserve Bank discount window -- a source of temporary financing that could accommodate larger than ordinary flows of credit through the banking system -- were therefore reviewed, up-

dated, and adapted for possible use in the event of a municipal securities market collapse.

Fourth, the Federal Reserve System has a bank regulatory responsibility, especially with regard to the supervision of state-chartered member banks. Through the spring and summer, the Federal Reserve Bank of New York kept itself informed as to the portfolio position in New York City issues by the City's major banks. Then in August, in order to spot where problems were most likely to develop, Federal Reserve examiners were asked to identify, from their worksheets, those state member banks throughout the country that held New York City, State or State agency securities accounting for a sizeable proportion of their capital accounts. Later that month, we obtained current data from these banks as to their holdings of New York City issues. I am submitting separately, for the Committee's use, a general summary of the results of these informal surveys.

The Federal Reserve staff intends to keep fully abreast of the financial and economic ramifications of the New York City problem on a day to day basis. All that can be said with confidence at this point is that the potential repercussions will depend importantly on the precise character of developments in the market and in the City's situation as they take place.

REPORT 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

C. L.

For release on delivery

Statement by

George W. Mitchell

Vice Chairman, Board of Governors of the Federal Reserve System

before the

Subcommittee on Commerce, Consumer and Monetary Affairs

of the

Committee on Government Operations

House of Representatives

June 25, 1975

Mr. Chairman:

I am pleased to appear before you today to present the Board's views as to the use of Federal Reserve credit facilities in providing emergency assistance to financially troubled cities. I want to state at the outset that we interpret the System's present powers to engage in such lending operations, except as member banks are involved, to be quite narrowly circumscribed by law.

The recent financing difficulties of New York City provide a case in point. These difficulties cumulated rapidly during this past winter and spring, and reflected the growing reluctance of private investors to purchase the City's short-term note issues. Since the City already had a very large amount of short-term debt outstanding, and was incurring a substantial current operating deficit as well, any inability to issue new debt raised immediate problems in finding the cash to pay off maturing obligations and meet the City's current bills. In searching for alternative means of resolving the developing financial crisis, there were at times suggestions that the Federal Reserve might be a possible source of credit in its role as an ultimate source of liquidity to the economy. However, no application for credit was received from the City, either at the Federal Reserve Bank of New York or the offices of the Board of Governors.

If a formal request had been received by the Federal Reserve for the emergency credit accommodation of New York City under the circumstances that had prevailed, however, I am obliged to state that, in my judgment, the Federal Reserve would have had to turn it down. The City had not fully exhausted possibilities for State assistance, and its basic need for credit did not appear to be of a temporary character since no near-term means of repayment--while continuing to provide the City's basic services--appeared to be at hand.

Direct extensions of emergency credit to institutions that are not members of the Federal Reserve System can be provided under either paragraph 3 or paragraph 13 of Section 13 of the Federal Reserve Act. Paragraph 13 provides that any Federal Reserve Bank, subject to such regulations as the Board may prescribe, may lend to any individual, partnership or corporation on promissory notes secured by direct obligations of the U. S. Government or an agency thereof. Loans under this paragraph are limited to 90-day maturities. Unless an entity in need of assistance possesses large amounts of direct government obligations, the ability of a Reserve Bank to provide credit assistance under this paragraph is very limited.

Paragraph 3 of the Act empowers the Board of Governors, in "unusual and exigent circumstances" and by an affirmative vote of at least five members of the Board, to authorize the Federal Reserve Banks to make certain types of direct loans to individuals,

partnerships or corporations. Paper discounted by Federal Reserve Banks under this paragraph must be of the "kinds and maturities made eligible for discount for member banks under other provisions" of the Federal Reserve Act. This means, among other things, that the paper may not have a maturity of more than 90 days at the time of discount. The paragraph further provides that the paper shall be "endorsed or otherwise secured to the satisfaction of the Federal Reserve Bank," which the Board has construed to mean that a Reserve Bank should ascertain that the security offered is adequate to protect the Reserve Bank against the risk of loss.

In light of these restrictions in the law and the background as to the intent of the law, the Board has concluded that, in considering the extension of emergency credit to particular borrowers, the following conditions must be met:

(1) unusual and exigent circumstances exist;

(2) potential borrowers have exhausted other sources of funds;

(3) the borrower is solvent and has adequate collateral;

(4) the borrower's need is for short-term accommodation and its basic financial position will permit early repayment; and

(5) failure to obtain Reserve Bank credit would have a significant detrimental economic and financial impact on the surrounding area, the region, or the nation.

These criteria highlight the essentially low-risk and temporary character of System emergency lending, as well as the general economic purpose behind it. Such lending is intended primarily to provide liquidity. Though short-term needs of this type can develop among either large governmental units or business enterprises, in most cases the need can be accommodated without relying directly on the Federal Reserve simply by turning to commercial banks--who will rely on their own or Federal Reserve resources--to extend the needed credit. When this is not possible, as seemed to be the case with New York City, it is likely that the difficulties encountered in the private credit markets reflect more fundamental credit-risk problems and that temporary credit accommodation will not be sufficient to correct the situation.

In addition to the emergency lending powers contained in Section 13 of the Federal Reserve Act, Section 14(b) authorizes the individual Federal Reserve Banks to purchase and sell obligations of State and local governmental bodies. The Act requires that these governmental obligations mature in no more than six months from date of purchase and that they be issued in anticipation of the collection of taxes or in anticipation of the receipt of assured revenues.

The 14(b) authority had its origin in the original 1913 version of the Federal Reserve Act. The House Report on the Act indicated that the provision was designed to open an outlet through which idle funds of Federal Reserve Banks could be profitably channeled and to provide a means to enable Federal Reserve Banks to make their discount rate

effective in the market at those times when member bank borrowing was slack. There is nothing in the Act or its legislative history to indicate that this authority was intended to be used as a channel for financial assistance to public bodies. Moreover, the authority has not been used since 1933, since enactment of Section 10(b) permitted the Federal Reserve to advance credit to member banks on the strength of their own promissory notes, as well as through the discount of eligible paper. Given this background, the Board does not believe that Section 14(b) contemplates the purchase of municipal obligations as a means of aiding financially distressed communities.

In view of these existing constraints on System emergency lending, it may be asked whether it would be desirable to legislate broader powers that would permit Federal Reserve accommodation of financially distressed communities. While the Board has not considered any specific proposals toward this end, I would strongly caution against any proposals that would provide direct access to central bank credit by hard-pressed governmental units. My reasons for reaching this judgment are as follows:

First, the critical issue for particular municipalities is how governmental functions and sources of revenues are dispersed between it and the State government. Prospective sources of funds must be commensurate with the projected costs and expenditure programs in order to balance out over the longer run. Access to a source of temporary credit will not help to achieve such a balance, and it may

tend to defer or prevent the remedial actions that are necessary, difficult as they may be.

Second, central bank involvement in providing temporary credit accommodation to State and local governmental bodies will necessarily require that standards be set determining which localities will be eligible or ineligible for credit accommodation. This would involve the System in making credit judgments on the finances of numbers of State and municipal governments, thus subjecting the Federal Reserve to intense political pressure to make exceptions for this city or that because of special circumstances. Moreover, the need to exercise administrative discipline over borrowers in order to assure timely repayment would tend to draw the System into political issues of local budgetary policy. A central bank, in our judgment, should leave this issue to other agencies of the Government.

Third, increased access to central bank credit by municipalities suffering some degree of financial distress could lead to similar urgent demands for credit by other kinds of borrowers. If central bank credit is extended to our cities, for example, why not for a host of other purposes, such as the immense investment that will be required to achieve energy independence? A proliferation of demands for credit from the central bank would drastically change the character of the assets of the Federal Reserve System, from prime paper of highest quality to an assortment of soft loans and, in the process, severely damage the Government's access to financing. It

could undermine our ability to control the volume of bank reserves and hence the supply of money. In the extreme, the result could be a debasement of the nation's money and ruinous domestic inflation.

For these reasons, if your Committee should conclude that the financial pressures on key municipalities requires the provision of special Federal financing assistance in the period ahead, the Board would strongly urge that this be done through a separate facility rather than the Federal Reserve. Federal monies or credits would still be expended in any such venture, but it would not involve the use of high-powered central bank funds. Such a separation would thus leave the Federal Reserve free to pursue its other responsibilities for monetary and bank regulatory policies, which are difficult enough in themselves.

I would urge caution, however, even in proposing the establishment of a special Federal financing facility to assist with the financing needs of our State and local governmental bodies. Such a facility must have sufficient oversight powers to permit it to play an effective role in correcting the fundamental financial problems of client communities, if the Federal assistance is to be productive. This would be bound to create a Federal presence in local issues of taxation and spending, a varied and shifting political and social terrain indeed.

In the spirit of our traditional system of separation of powers, it may well be better to leave local problems to local solutions.

The special program of financial assistance which was developed for New York City at the State level through the formation of a new agency--the Municipal Assistance Corporation--is an illustration of State-local resourcefulness. The Corporation is authorized to provide up to $3 billion in credit to the City and, as it does so, valuable time will be gained in which the City can take the steps needed to restore its credit standing with the private investment community. I hope that the City's actions will soon make it possible to carry on needed refinancing and other debt operations in the normal manner.

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C.A.T.
10/23/75

Essential Points to Consider

1. The ultimate goal is resolution of New York City problem consistent with minimizing short- and long-run risks in dealing with the New York City situation.

   a. Short-run risks -- possible damage to process of economic recovery, potential damage to securities markets, potential hardships facing City residents, etc.

   b. Long-run risks -- Fed. aid would establish dangerous precedent (Federal involvement in local affairs, reduces need for fiscal discipline).

   c. A program of Federal assistance containing sufficiently stringent eligibility conditions and a minimum of Federal exposure could achieve this goal. Program outlined in testimony does this.

   d. Some voluntary measures of reorganization of City finances could also be a pre-condition for Federal aid. Such measures might be reduction of pension fund costs and reorganization of City debts (stretch-out of maturities, reduction of interest). Such measures would also reduce long-run risks.

2. There is a case to be made for Federal assistance, even in the event of default.

   --- City has large cash flow needs. Such needs are, of course, much smaller in the event of default. However, some source of funds (pension funds, Federal assistance) would be needed if City is to avoid great hardships.

3. Bankruptcy laws should be revised. Present laws would not provide for orderly environment in event of default of New York City. Default is a possibility since enactment of legislation of Federal assistance is unclear.

C.L.

Public Law 94-143
94th Congress, H. R. 10481
December 9, 1975

An Act

To authorize the Secretary of the Treasury to provide seasonal financing for the city of New York.

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

New York City Seasonal Financing Act of 1975.

SHORT TITLE

SECTION 1. This Act may be cited as the "New York City Seasonal Financing Act of 1975". 31 USC 1501 note.

FINDINGS AND DECLARATIONS

SEC. 2. The Congress makes the following findings and declarations: 31 USC 1501.

(1) It is necessary for the city of New York to obtain seasonal financing from time to time because the city's revenues and expenditures, even when in balance on an annual basis, are not received and disbursed at equivalent rates throughout the year.

(2) At the present time the city is or may be unable to obtain such seasonal financing from its customary sources.

(3) It is necessary to assure such seasonal financing, in order that the city of New York may maintain essential governmental services.

DEFINITIONS

SEC. 3. As used in this Act: 31 USC 1502.

(a) "City" and "State" mean the city and State of New York, respectively.

(b) "Financing agent" means any agency duly authorized by State law to act on behalf or in the interest of the city with respect to the city's financial affairs.

(c) "Secretary" means the Secretary of the Treasury.

LOANS

SEC. 4. (a) Upon written request of the city or a financing agent, the Secretary may make loans to the city or such financing agent subject to the provisions of this Act, but in the case of any loan to a financing agent, the city and such agent shall be jointly and severally liable thereon. 31 USC 1503.

(b) Each such loan shall mature not later than the last day of the city's fiscal year in which it was made, and shall bear interest at an annual rate 1 per centum per annum greater than the current average market yield on outstanding marketable obligations of the United States with remaining periods to maturity comparable to the maturities of such loan, as determined by the Secretary at the time of the loan.

SECURITY FOR LOANS

SEC. 5. In connection with any loan under this Act, the Secretary may require the city and any financing agent and, where he deems necessary, the State, to provide such security as he deems appropriate. 31 USC 1504.

The Secretary may take such steps as he deems necessary to realize upon any collateral in which the United States has a security interest pursuant to this section to enforce any claim the United States may have against the city or any financing agent pursuant to this Act. Notwithstanding any other provision of law, Acts making appropriations may provide for the withholding of any payments from the United States to the city, either directly or through the State, which may be or may become due pursuant to any law and offset the amount of such withheld payments against any claim the Secretary may have against the city or any financing agent pursuant to this Act. With respect to debts incurred pursuant to this Act, for the purposes of section 3466 of the Revised Statutes (31 U.S.C. 191) the term "person" includes the city or any financing agent.

"Person."

LIMITATIONS AND CRITERIA

31 USC 1505.

SEC. 6. (a) A loan may be made under this Act only if the Secretary determines that there is a reasonable prospect of repayment of the loan in accordance with its terms and conditions. In making the loan, the Secretary may require such terms and conditions as he may deem appropriate to insure repayment. The Secretary is authorized to agree to any modification, amendment, or waiver of any such term or condition as he deems desirable to protect the interests of the United States.

(b) At no time shall the amount of loans outstanding under this Act exceed in the aggregate $2,300,000,000.

(c) No loan shall be provided under this Act unless (1) the city and all financing agents shall have repaid according to their terms all prior loans under this Act which have matured, and (2) the city and all financing agents shall be in compliance with the terms of any such outstanding loans.

REMEDIES

31 USC 1506.

SEC. 7. The remedies of the Secretary prescribed in this Act shall be cumulative and not in limitation of or substitution for any other remedies available to the Secretary or the United States.

FUNDING

New York City Seasonal Financing Fund. Establishment. 31 USC 1507. Appropriation authorization.

SEC. 8. (a) There is hereby established in the Treasury a New York City Seasonal Financing Fund to be administered by the Secretary. The fund shall be used for the purpose of making loans pursuant to this Act. There is authorized to be appropriated to such fund the sum of $2,300,000,000. All funds received by the Secretary in the payment of principal of any loan made under this Act shall be paid into the fund. All income from loans and investments made from the fund shall be covered into the Treasury as miscellaneous receipts. Moneys in the fund not needed for current operations may be invested in direct obligations of, or obligations that are fully guaranteed as to principal and interest by, the United States or any agency thereof. After all loans made pursuant to this Act have been repaid, the balance of the fund shall be returned to the general fund of the Treasury.

(b) The Secretary is authorized to sell, assign, or otherwise transfer from the fund any note or other evidence of any loan made pursuant to this Act to the Federal Financing Bank and, in addition to its other powers, such Bank is authorized to purchase, receive, or otherwise acquire the same.

(c) There are authorized to be appropriated such sums as may be necessary to pay the expenses of administration of this Act. Appropriation authorization.

INSPECTION OF DOCUMENTS

SEC. 9. At any time a request for a loan is pending or a loan is outstanding under this Act, the Secretary is authorized to inspect and copy all accounts, books, records, memorandums, correspondence, and other documents of the city or any financing agent relating to its financial affairs. 31 USC 1508.

AUDITS

SEC. 10. (a) No loan may be made under this Act for the benefit of any State or city unless the General Accounting Office is authorized to make such audits as may be deemed appropriate by either the Secretary or the General Accounting Office of all accounts, books, records, and transactions of the State, the political subdivision, if any, involved, and any agency or instrumentality of such State or political subdivision. The General Accounting Office shall report the results of any such audit to the Secretary and to the Congress. 31 USC 1509.

TERMINATION

SEC. 11. The authority of the Secretary to make any loan under this Act terminates on June 30, 1978. Such termination does not affect the carrying out of any transaction entered into pursuant to this Act prior to that date, or the taking of any action necessary to preserve or protect the interests of the United States arising out of any loan under this Act. 31 USC 1510.

Approved December 9, 1975.

LEGISLATIVE HISTORY:

HOUSE REPORTS: No. 94-632 Pt. 1 (Comm. on Banking, Currency and Housing), Pt. 2 (Comm. on Ways and Means).
SENATE REPORT No. 94-443 (Comm. on Banking, Housing and Urban Affairs).
CONGRESSIONAL RECORD, Vol. 121 (1975):
Dec. 2, considered and passed House.
Dec. 3-5, considered and passed Senate.

GPO 57-139

These statements
are nearly
identical

C.L.

For release on delivery

Statement by

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.

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C L.

Qs + As did not follow
up on Fed as source of
Emergency credit.

For release on delivery

Statement by

Arthur F. Burns

Chairman, Board of Governors of the Federal Reserve System

before the

Subcommittee on Economic Stabilization

Committee on Banking, Currency and Housing

House of Representatives

October 23, 1975

I am here to discuss with this Committee 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.

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. In the absence of clear-cut remedial measures by the City, the possibility of default on the City's obligations became very real, and it was so portrayed almost daily in our 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 instrumentality -- the Municipal Assistance Corporation (MAC). This agency was empowered to sell up to $3 billion of its debt obligations, to make the proceeds of its borrowing available to the City, 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. These included creation of a State-dominated Emergency Financial Control Board to manage the City's finances, expansion of MAC's authority to issue securities, and a plan to arrange additional financing of $2.3 billion for the City. This financial

package was designed to tide the City over until early December. It was hoped that by that time a strong program of budgetary restraints would be in place and that it would enable the City to resume the sale of its securities to the investing public.

But the new financial plan failed to elicit any enthusiasm on the part of investors. The financial community has remained skeptical about the City's ability to avert default and rebuild its financial strength. Moreover, the intertwining of the State's finances with the City's finances has troubled investors and has damaged the State's credit standing. The concern of market participants was heightened this past week by the extraordinary difficulties encountered in arranging for the City's refunding needs on October 17, and default was averted by only an hour or two. Thus, the stresses and strains that began to develop in the municipal securities market in the summer have become more acute with the passage of time.

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. Underwriters of municipal issues have generally reduced their participation in new offerings, and some have withdrawn 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 behavior of investors and dealers in recent months has resulted in a rise of yields on municipal securities to the highest level ever experienced in the tax-exempt market. Yields for even the highest-rated borrowers have risen conspicuously, but a part of this increase is doubtless due to the enormous volume of municipal securities issued during the third quarter.

In the past two to three weeks, open-market interest rates have declined somewhat. The municipal market has benefitted from this development, as well as from various indications that the Federal Government is becoming more concerned about New York's financial problems. Nevertheless, investors in municipal securities remain highly selective. The obligations of New York City, New York State, and certain of the State's agencies continue to be shunned by investors. And the effects of investor uncertainty have spilled over to other governmental units as well, some of which have not received any bids for their bonds or have rejected bids because the interest cost was deemed excessive.

If the weakness of the market for municipal securities were to persist and to spread further, many soundly run, credit-worthy communities and public agencies could have difficulty -- or suffer very heavy costs -- in raising needed funds. This would tend to induce cutbacks or stretchouts in local spending programs. In addition, holders of municipal securities, which include many banks and other financial institutions, would to some degree be affected, as might the attitudes of 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 impaired.

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 has been 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 law, 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 have already indicated in testimony before the Joint Economic 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 Federal 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 agencies have plans to revise procedures that apply to the valuation of defaulted securities, so that any writedowns

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 might ultimately require writedowns that could seriously reduce 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 portfolios. 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 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 default by New York City would probably be shortlived.

Indeed, the possibility of such a default has already been discounted to a considerable 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 indicates 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 to other hard-pressed communities, even though their distress may have been brought on by gross negligence or mismanagement. Substantial Federal aid -- 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 governments would necessarily inject a major Federal presence in local spending and taxing decisions.

These longer-run dangers have a vital bearing on our Nation's future; but they can be exaggerated, just as the immediate consequences of a New York default can be -- and perhaps are now being -- exaggerated. It is entirely clear to me that if the Federal Government had previously yielded to the entreaties for aid that New York officials kept pressing, neither the City nor the State would have gone as far as they now have in restoring some hope for eventual order in the City's finances. Earlier intervention would have been a disservice to the people of New York as well as to the Nation at large. But it also seems to me that the effort thus far made by both the State and the City is still inadequate. And while I take a more serious view of the potential economic consequences of a New York default than I did three

months ago or even three weeks ago, I am not ready to recommend to the Congress that financial assistance to New York is now required in the Nation's interest.

I was asked at a recent Hearing what advice I would give if Congress were inclined to legislate assistance for New York. My reply was that stringent conditions should in that event be laid down, so that no municipality would seek Federal financial aid unless such a request became unavoidable. I proceeded to list a half-dozen conditions; and, if I may, I shall now restate them somewhat more fully.

One essential condition prior to receipt of any Federal assistance would be that the municipality has exhausted all other sources of funds. This would require, of course, that the municipality demonstrate that it is unable to obtain credit through the public issuance of securities, or through private placement of securities, or direct loans from banks or other private lenders.

A second condition that seems to me essential is that the State assume control over the finances of the municipality in difficulty. When a local government reaches the point where no source of funds is any longer available, its management of

finances can no longer be relied upon. State control would mean that a local government has lost its fiscal authority, and this should serve as a powerful deterrent to other mayors or city councils across the Nation from ever placing their municipality in such a position.

A third essential condition for Federal assistance, I believe, should be that the State levy a special State-wide tax, the proceeds of which are pledged to cover one-half of the deficit faced by the municipality. The requirement of such a tax would materially strengthen the State's resolve to put whatever pressure is needed on the troubled municipality to work its way toward a balanced budget. It would thus insure that the State will discharge adequately its own responsibility to enforce fiscal discipline on a troubled municipality. No governor or State legislature will welcome the prospect of levying a special State-wide tax for the benefit of a municipality that has mismanaged its affairs. But this very reluctance would provide some assurance that Federal assistance would not be expected until an effective City-State program of remedial action, no matter how politically troublesome this may prove, has been developed.

Fourth, prior to receipt of Federal assistance, a detailed financial plan would need to be presented for approval by the Federal authority charged with administering the assistance program. Criteria for accepting a plan would have to be spelled out -- such as the use of standard accounting procedures, unrestricted access by the Federal authority to all local financial records, provision for retiring short-term debt other than that required to handle seasonal discrepancies between expenditures and receipts, and so on. Clearly, the plan should provide for restoration of sound municipal finances within a relatively short period and certainly within two fiscal years.

Fifth, a municipality that obtains a Federal guarantee for the payment of principal and interest on its issuance of new securities should be required to pay an appropriate guarantee fee. The municipal security should be taxable, but tax-exempt bonds might be permitted in special cases -- for example, if return to non-guaranteed status were thus eased. In such cases, the guarantee fee would naturally have to be much higher than if the security were taxable.

Sixth, and finally, the Federal guarantee program should be of limited scope and duration. The total amount of

guaranteed debt should be set at the lowest practical figure. The debt instruments should be of short maturity so that the guarantee may be reconsidered periodically. In order to minimize Federal exposure to risk and to assure compliance with the approved financial plan, the Federal Government should have authority to withhold revenue-sharing funds from a delinquent municipality. At the end of a relatively short period, say three years, all Federally guaranteed debt under the program should have expired.

If conditions along the several lines I have here suggested were included in a legislative plan for assisting troubled municipalities, the number of applicants that might seek Federal aid would be severely limited. It is highly important to recognize that the issue of assistance to New York City goes to the very heart of our system of separation of powers between the Federal and State governments -- a system that, despite enormous economic and social changes, is still honored by our country. If there is to be any legislation on assisting local governments, it should at least be designed so that the longer-run risks to our Federal system of government are kept to a minimum.

Before bringing this testimony to a close, I want to make two additional comments briefly.

First, recent attention to New York City's difficulties has brought to the fore certain shortcomings of our bankruptcy laws. It is highly important that the Congress enact legislation that would enable the judiciary to deal with a municipal default so that reorganization of outstanding debts, service or employee contracts, and other financial obligations may proceed in an orderly and expeditious manner.

Second, the behavior of financial markets has recently been disturbed by the grave uncertainties surrounding New York City finances. A quick but well considered decision by the Congress to assist or not to assist New York is now urgently needed. Almost any resolution of these uncertainties may be better than prolonged debate and controversy. Financial markets do not thrive in such an environment.

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