OVERSIGHT ON THE NEW YORK CITY
SEASONAL FINANCING ACT

HEARINGS
BEFORE THE
COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE
NINETY-FIFTH CONGRESS
FIRST SESSION
ON
CONTINUING OVERSIGHT ON THE ADMINISTRATION AND
PROGRESS OF THE NEW YORK CITY SEASONAL FINANCING
ACT OF 1975 (PUBLIC LAW 94-149)

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New York City is particularly able to maintain its historic position if it can depend upon a reasonable share of Federal assistance. Foreign investors have begun to recognize that the City presently has, an extensive and highly trained labor pool, a concentrated and well-developed set of service industries, a comprehensive and sophisticated transportation network which is economic and energy-efficient. This system could be greatly enhanced with an equitable share of Federal mass transit assistance.

I cannot conclude without coming to your attention the considerable progress which has been made in developing plans for the City's economy. These plans are being realized through the cooperative efforts of New York City, the State and the Federal government. New York City has recognized its economic potential and has created a development agency whose role in the immediate future is to promote economic revival of the business core of New York City. The construction of a new railroad, on the lines of New York City's role as a center of trade and tourism.

Progress toward the stabilization of New York City both financially and economically is a tribute to the close cooperation between the City and the Federal government. The New York City's Financial Control Board, the staff of the City's Financial Control Board, and the Federal government have worked hard to ensure the success of the revitalization plan. The continuation of these joint efforts should be a source of great encouragement to us all.

I can say as Governor of New York State that I believe the New York City's Financial Control Board and I believe the combined efforts of the Board and the City will be successful. It is just as our problems are interdependent, so will be the solutions to them. I look forward to the continued cooperation of the Congress in meeting the needs of the people of New York State and New York City.

The Chairman. Thank you, Governor Carey, for once again, a most impressive statement. I think your fight over the last couple of years for New York City has been certainly one of the principal reasons why the Federal Government was able to provide the assistance it did provide to the city.

Much of your statement is of the way that the State has assisted the city and, of course, that's proper. At the same time, I think we all realize that the cities are the creatures of the State and many of us realize that the cities are the creatures of the State and the State has a fundamental responsibility and that, as a matter of fact, it wasn't for the obvious fact that New York City's budget as I understand it is as big or bigger than New York State budget that you have such a colossal problem there—

Governor Carey. About $11.4 billion for the State budget and $13.9 billion for the city, and all but $3 or $4 billion of the State's budget is shared with the localities.

The Chairman. As I say, if it weren't for that situation, the Federal Government wouldn't have acted and shouldn't have acted. If the State has the resources to do the job, the Federal Government should stay out. The cities are the problems of the State and I think we should recognize that.

Here I do think we had an unusual kind of situation and I think, as you point out, the State has done well.

Let me ask you this. As chairman of the emergency financial control board, you pass on the city's fiscal year 1978 financial plan to determine whether it presents a balanced budget as required by law. Based on preliminary reviews, do you see any problems in the mayor's executive budget for fiscal year 1978 that might prevent the city from meeting this budget balancing requirement?

Governor Carey. Yes, I do see problem areas. I mentioned that there are contingency funds in there, such as countercyclical funds and money which must be derived or should be derived from the sale of Mitchell-Lama mortgages and so forth. The precise data on where those uncertainties lie, of course, are not unknown to the mayor and he recognizes those in the budget and they carry this contingency.

The Chairman. What I'm asking is whether or not there are sufficient backups in the event some of these don't develop as you'd like them to the city will still be able to do the job.

Governor Carey. The city has said that lacking these contingencies, they are prepared to adopt alternative plans to offset any of the loss.

The Chairman. Are those plans articulated? Are they known? Do you feel they are adequate?

Governor Carey. Let's take the moneys that would be invested in the MAG stretch. If the idea does not occur, then MAG has other resourceful ideas on how it can help the city, for instance, on the Mitchell-Lama shortfall. I would like to share some of these ideas with Mr. Rohatyn and Mr. Berger, who are here today. Mr. Berger has carefully diagnosed the city's budget, which must also be reviewed by the city board of estimate and the city council. The final budget adopted by the city after this review process will be the one we have to address.

Now we don't see any great travail there because it's basically a good document going in, and all those developing it—the mayor and the board of estimate and the city council—must be aware that there's
Governor Carey. It would help if that could be done, but we now come to the point of a phased out of $600 million from 10 years to five years, a shorter period which places a heavier burden upon the services of the city than is now the case.

Mr. Rohatyn. Senator, I am not sure that phasing it out more rapidly would make a substantial difference. I think the more important issue is one of disclosure and proper accounting and of the investors seeing that that is being phased out properly. It may have some impact if we phased it out over 5 years instead of 10 years, but we would also have to consider the tradeoff question of what it would do to the city's ability to function. I think that more important in terms of investor confidence is the stabilization of the city's tax base and the revenue structure of the city, and as the Senate I think it might make some difference.

The Chairman. From an investor's standpoint, you think it's not critical, although it's important, but not crucial.

Let me ask you if there's a real problem involved here. I understand the city's bond counsel has questioned whether it's legal under the state constitution for the city to issue bonds for capital projects which also include operating expenses since they don't result in an asset.

Mr. Rohatyn. There is a legal problem that's being researched now. I think the legal problem may be a much larger impediment.

The Chairman. Could the city be legally barred from floating bonds as far as the operating expenses remain in the capital budget?

Mr. Rohatyn. I think it might be hampered in terms of the amounts they can finance. I'm not sure the would be completely shut out of the market.

The Chairman. That limitation might make it difficult for you to provide the kind of private financing to make it possible—we all hope you can do—which is to end the seasonal loan.

Mr. Rohatyn. The city's ability to borrow in amounts adequate for its needs might be hampered. These are a couple of items I will be addressing shortly.

The Chairman. Now you balanced the budget as I understand it in 1978 allowing for this operating expenses matter. But I'm concerned that the city's budget projects now a deficit after fiscal year 1978 and the investor certainly would look at that—deficit of $86 million in 1979 and then $93 million in 1980. You're almost in balance in 1981, a $3 million deficit. I understand, adding up to a cumulative deficit of $984 in the absence of any offsetting action.

Has the Control Board directed the city to supply a detailed financial projection for 1979 as Mr. Berger recommended earlier this year?

Governor Carey. We have so directed, but here we are in the uncertainty of 1979 and 1980 and our target for the 1978-79 budget has been, since Mr. Axelrod first proposed the financial plan, an $86 million gap. The city, as I said, has done a monumental job in closing gaps up to now, and ahead of schedule. Attrition, for instance, has proceeded far better than we had anticipated in terms of the cost of the personnel services. We are not suffering from it, but we are now in the plight of full disclosure and I would only say that we in the State have a 3-year projection that shows we have difficult days ahead.
until our economy levels out from what is still a low equilibrium and stable basis.

The Chairman. With a $13 billion budget, you would think that eliminating the $85 million on an $829 million deficit would be something that would be achievable. I realize you have made enormous progress and that you have cut and cut very hard and it's difficult to make the cuts now, but it would seem that putting that in perspective that $82 million, which is the biggest deficit you will have in 1980, that with a $13 billion budget that doesn't seem to be insuperable.

Governor Carey. I know you will hear from the mayor and its been repeated and its rejection does not detract from its veracity. There is just so much of tax levy funds to be cut. In that $13.9 billion of the city budget, there are the costs of the agencies, the hospital corporation which reflects its own $235 million or more deficit; the cost of the board of education and the schools. Few cities have the burden of school costs that New York City has. When you get down to the available area that can be cut of so-called tax levy funds, you're talking about the funds for sanitation, police, fire—and we have reached the point in those services where to reduce them further would jeopardize the lives of the citizens of that city. That's no such thing as a cut.

I didn't even mention, by the way, the heavy component of that budget which is debt service, a major component of our cost. We can't, through the devices and the ingenuity and the determination of MAC, assist in lowering that cost of debt service which is what MAC is all about.

The Chairman. My time is up, let me ask a final question. Will you require that the financial plan keep in budget because balance in 1978 before you approve the financial plan for 1978?

Governor Carey. Senator, I don't know where I will be in 1979. I cannot give you that assurance.

The Chairman. I'm saying before you approve the financial plan for 1978.

Governor Carey. There are moves afoot in a sense of going to market to get a long-term bond or a bond which would be of a longer term than the short-term borrowings which are opposed by most of us. In order to do that there will have to be some monitoring mechanism to which Mr. Rolph, I will address himself. A new monitoring mechanism may well involve the elimination of the emergency control board. But as long as the board, which has worked effectively, is the chairman, we will insure that our mandate and our statutory responsibility is carried out so that there will be a balanced budget.

The Chairman. Well, I appreciate that, but I wonder if you can do any more in the few days that remain relatively between now and the beginning of fiscal 1978 so that before you approve the fiscal 1978 financial plan you will require a balanced budget in 1979?

Governor Carey. Well, Mr. Berger mentioned there will be an exhaustive review and analysis of 1978-79. We will do all which is possible.
are dragging the national economy down with 10-percent unemployment in New York City and about a point lower across the State. The 7-percent national unemployment average is pulled up to that level by our high unemployment in New York City. So we’re pulling you back and holding you back and we want the country to move ahead.

Senator Lugar. Let me ask two more intergovernmental questions. Granted that the welfare predicament in both New York City and the State as a whole—

Governor Carey. And the counties. It's just as severe in the counties as in the cities.

Senator Lugar. And you have mentioned the transportation situation—subways and other methods of mass transit. What sort of answers can you give as Governor of New York to people representing other States, for example, in terms of the general equity of money flows to New York State?

For example, in Indiana, we do not have a complex mass transit system and most Federal bills to that effect are not going to be of great benefit to us. Likewise, the different evolution of welfare payments of the welfare system so that a substantial change along the lines that you were mentioning seems to me are likely to lead to inequity for the State of Indiana and for many others.

Governor Carey. Senator, when Studebaker was going down the drain we stepped in to the aid of Studebaker. I recall that. Do you remember when Studebaker was unable to survive and we thought that was a national calamity? Congress helped Studebaker.

Senator Lugar. I suspect the Studebaker case will not really stand for the sort of monumental shifts we’re talking about in terms of welfare.

Governor Carey. I remind you that we did it, and if we can save Studebaker, whichever it stands now, we should be able to save New York City.

Senator Lugar. I think the problem really needs to be answered by you and those representing New York and I ask it not in an antagonistic way.

Governor Carey. We are not pleading for special treatment. In my first term as a Member of Congress, when I went to Lima, to Wabash, to Peru—all those wonderful places in Indiana—we traveled by bus. A very efficient chairman was very careful about spending committee funds and the buses at that time were not very comfortable. I hope they have improved.

Senator Lugar. No! I don’t think they have improved a great deal.

Governor Carey. Then we want better buses for Indiana.

Senator Lugar. That comes to the heart of the matter which I think really at some point you have to address. That is, why should citizens in the State of Indiana be spending money for more adequate transportation system in New York City?

Governor Carey. Because we don’t build equipment in New York City or New York State for that system. Our purchasing power goes throughout the country. We buy our rails from the steel mills of Pittsburgh or wherever the rails are forged, and the rails are manufactured, and our rolling stock is built nowhere in our State. So we become, frankly, a good source of purchasing power for the vendors in Indiana and elsewhere. I’d like to see the steel mills in Gary and all of the activities in Cleveland and Toledo Ohio and the other parts of our country supported by a vital economy, a vigorous economy in New York City.

Senator Lugar. I would, too. Now let me ask a question from the other standpoint; and that is, with the Federal Government anticipating deficits of $94 billion, as is the current situation, what would be your advice to the Federal Government in terms of adopting expensive programs that go well beyond that budget? Surely changes in welfare reform or transportation and other situations will take us beyond that. What sort of advice and counsel as a citizen of the United States do you have to those of us who have responsibilities here?

Governor Carey. I will take Mr. Land’s aphorism, if it ain’t broke, don’t fix it.

Now, the welfare system is broken, it needs fixing; but you can’t fix it and repair it without money.

If you give me the choice, hold up the B-1 bomber and let’s take care of the welfare reform.

But I am not here any more, thank you.

When I was here, I did march up the Hill with a welfare reform program supported by the Nixon and Ford administrations. It went through the House and floundered in the Senate.

It shouldn’t happen again, because welfare reform and the containment of Medicaid costs will, in the long run, be an economy for this great country.

If you give us a way, we will have welfare reform, so we can train people for jobs.

If you give us a way to substitute employment to the disparage of welfare, crime will be contained in our society. That is proven. If you give us a way to address the breakdown of mass transit, we can show you that by containing the costs of conducting city government, our economy can make a greater contribution than simply asking for more funds for unemployment insurance.

Many States, some 30 in number, are going to have to borrow to pay Federal unemployment compensation because they are broke. That $94 billion deficit that now exists and states us in the face won’t be helped by a simple remote attitude by the Federal Government toward the problems of the central cities and older States.

We can participate in that economy.

I will not discuss with you at any other time our plans in the Northeast for an energy development program in which we could use the purchasing power of the Northeast in cooperation and the Appalachian region to bring about recovery in Appalachia instead of contributing to the coffers of the Middle East.

Senator Lugar. Thank you. My time is up. I am sympathetic with what you are saying, but I think the basic question that I have asked, that is, in terms of equity to other parts of the country and the general budget situation are important ones.

I think we have been trying to address them and I think we will have to be addressed before there is movement.

Governor Carey. We don’t want special help or special treatment. We don’t want to be a drain on the national economy. We proved the
point beyond any contradiction that bankruptcy in New York City would have hurt Indianapolis and all the other major cities of this country. That is no longer arguable.

So, since we are not talking about insolvency, we are talking about recovery on a national scale. We want to be part of that recovery. We are not suggesting any special treatment whatsoever. I am, in a sense, restating the pledge made by the President of the United States toward welfare reform. We would like that pledge redeemed.

Senator Leach. Thank you.

The CHAIRMAN: Senator Schmitt.

Senator Schmitt. Mr. Chairman, I will defer to my colleagues from New York. They may have other things they need to do. It not while later.

Governor Carey. Mr. Chairman, if I may, Mr. Rahatyn has a short prepared statement.

The CHAIRMAN. That's fine.

Mr. RAHATYN. Thank you, Mr. Chairman.

Governor Carey has asked me to comment on the city's current financing situation and on the city's prospects for future financing. You may recall that our last appearance before this committee coincided with the judicial decision which declared unconstitutional the 3-year moratorium on certain city notes held by the public.

As a result, the city, already under serious financial strain to reach a balanced budget for fiscal year 1978, was required to raise almost $1 billion to pay off those notes.

At that hearing, I outlined a plan to finance a moratorium debt, to be provided primarily on three elements:

About half to be provided by the sale of MAC securities and the remainder to be provided by a voluntary restructuring of MAC debt held by certain New York banks and pension systems, as well as by the proceeds of the sale of Mitchell-Lama mortgages.

While no final agreement on restructuring the MAC debt has been reached, I am pleased to report the billion dollars of publicly-researched schedule, following the rough outlines of the plan we proposed last year, and without materially affecting the city's capacity to reach a balanced budget for fiscal 1978.

We have been particularly encouraged by the market's response to the issuance of MAC securities during this time. Our exchange offer of last month, which was a keystone of the moratorium refinancing plan, whereby MAC bonds were offered in exchange for city notes, was an unqualified success, producing more than $8 million in exchanges, well above the $50 million originally targeted.

In addition, in the wake of a recent court of appeals decision reaffirming the constitutionality of MAC's revenue flow, we are now planning to issue an additional $100 million of MAC bonds for our previous offerings. Significantly, the terms for this new offering will be set by competitive bids for the first time since MAC was created.

This is a further indication of the growing confidence of the marketplace in MAC securities, and will reduce the cost of the financing we must provide to maintain essential city services.

The total of $800 million we thus projected to make available to the city through these offerings should provide enough of a cushion to assure that the moratorium debt can be paid in timely fashion, even if the city continues to fall short of its goals for the sale of Mitchell-Lama mortgages.

This will leave approximately $500 million of notes in the hands of the New York banks and pension systems, and I expect that over the next few months negotiations with respect to the disposition of those notes can be successfully achieved among the city, the MAC and those noteholders.

When MAC was created 2 years ago, the Governor assigned essentially four missions to us:

1. The first was to keep the city out of bankruptcy. The second was to refinance all of the city's short-term debt, amounting to approximately $8 billion at the end of May 1975 on a long-term basis.

2. Third was to help bring the city back to a balanced budget within the 3-year financial plan. And last was to help bring the city back to the public markets on its own.

The first two of these missions have essentially been accomplished. With the refinancing of the publicly held moratorium notes, MAC will have refinanced something over $4 billion of short-term city notes on the basis of average maturities of about 13 years and an average interest rate of approximately 9 percent.

In addition, MAC helped to raise from the New York City pension systems an additional $2.5 billion in city bonds to finance the city during 1975-76.

The city's 1975 budget is presently under study by our staff. Our preliminary review indicates that it appears to be balanced in accordance with the terms of the MAC statute. It is, however, balanced precariously. A substantial infusion of Federal counter-cyclical aid and other potentially nonrecurring revenues and savings are included in the absence of which, in future years, raises again the specter of significant deficits after fiscal 1978. In addition, under State law, the city will have to continue phasing out its practice of borrowing to meet certain expense items in its capital budget more than $600 million of which appear currently at a rate of about $75 million a year through 1986.

The key uncertainty for fiscal 1978 is still some $250 million in the city's budget from the resetting of maturities on approximately $1.8 billion of MAC bonds held by certain New York City institutions. Agreement on what we call the "MAC stretch" has so far not been achieved, but I am hopeful that over the next month or so negotiations currently taking place between the city, the banks and the unions will ultimately be successful.

If this is not the case, the city knows that it will have to come up with alternative programs equivalent to this amount prior to its July 1 budget going into effect.
The financing outlook for fiscal 1978 is certainly more hopeful than it has been for the last 2 years.

The present commitments from the pension systems, together with the current seasonal loan program, should see the city through its 1978 financing needs.

Under the Federal credit agreement the city is required to test the markets beginning July 1, 1977.

I would expect that, with the cooperation of the financial institutions, short-term seasonal financing in moderate amounts should be possible during fiscal 1978.

Assuming that the emergency financial control board approves a balanced budget and in view of the fact that the control board will stay in being until at least December 31, 1978, it should be possible, in my judgment, both technically and creditwise, for the city to issue possibly up to $500 million of short-term notes through normal commercial banking channels as the year goes on. I expect that negotiations with respect to such financing between the city and the banks will be starting shortly.

The key test, of course, will be the city's reentry into the long-term debt market. As you know, negotiations carried on last fall as part of the moratorium refinancing between the city and the clearinghouse banks broke down on the issue of long-term fiscal oversight.

In my judgment, this is a resolvable issue. It requires political will on the part of the city and somewhat more flexibility on the part of the banks.

It requires everybody's recognition that fiscal oversight for some period of time is an absolute necessity, but should differentiate control and oversight, at least as long as the city stays on an even keel.

We have our own views at MAC about the kind of mechanism that might be appropriate and we will obviously be available to all parties at the time such negotiations resume.

The mayor's mandate is just beginning to come into full swing. And, as you know better than I, during such a period, sanity and clarity of vision are not going to be in abundant supply in our city, and the fiscal oversight mechanism to go with it will have to be postponed until the fall.

It is my judgment that during fiscal 1978 an agreement should be concluded between the city and the banks on the subject, and that some modest refinancing of the long-term bonds will take place before the end of the fiscal year, in amounts of maybe $290-320 million.

This then brings us to the period following June 30, 1978. It is obviously difficult to predict what the city will be able to finance at that time.


I remain skeptical about the city's ability, on its own, to raise approximately $4 billion of both seasonal financing and capital finance in fiscal 1979, no matter what.

In my judgment, the city will either require an extension of the Seasonal Financing Act, possibly on a phasing-down-and-out basis, or some form of Federal financing assistance for its long-term capital needs (possibly through the mechanism of an urban bank or guarantee).

New York City is, fortunately and unfortunately, not just one piece of the urban problem. Its size alone in financing creates a unique problem of market access. Its current debt service of $2.8 billion per annum still constitutes a terrible burden for the city, both from a budgetary and economic development point of view. A refinancing facility, mostly for city bonds, could be very useful. The MAC debt structure, especially if agreement is reached with respect to the MAC stretch, is reasonably satisfactory, and over a period of time, assuming our market performance continues to improve, we should be able to refinance MAC at lower interest rates and longer maturities on our own.

The city bond structure, however, amounting to some $6 billion, is plagued by very short maturities and resetting of the City debt on a much longer term basis would be of considerable help in enabling us to lower taxes and undertake economic development.

In closing, as we reach the end of MAC's second year of existence, I would like to say to you that we have come a long way. In our fight to save the city, however, it is only the end of the beginning.

I believe we have helped to create a stable base on which one can build a solid structure.

How it all ends will depend on the city's willingness to continue its austerity and to rebuild its tax base, on the State and the region addressing themselves successfully to regional problems, such as sky-high energy costs, and on a Federal resolution, once and for all, of the welfare burden which so crushing hangs on the back of the city.

Thank you.

The CHAIRMAN. Thank you for your most interesting and useful statement.

Governor Carey. Deputy Comptroller Schwartz has a brief statement to give on behalf of the Comptroller of the State of New York.

Mr. SCHWARTZ. Gentlemen, thank you for the opportunity to present some of the concerns of my office in connection with the financial emergency in New York City. The solution to the emergency may be viewed as having two major aspects. One, the achievement by the city of a balanced budget for fiscal year 1978 and thereafter; and, two, the ability of the city to reenter the Nation's Capital markets to obtain the financing it will need after June 1978.

As you know, New York City has recently submitted its proposed balanced budget for fiscal year 1978. This budget is being evaluated by the staff in the light of the requirements of the New York State Financial Emergency Act of 1975. We expect to report on our evaluation early in June. Thereafter, we will report on the city's budget estimates for fiscal years 1978, 1979, and 1981.

It appears to be substantial progress toward meeting the first of the two aspects of the solution to the financial emergency. Thus it
seems appropriate now to focus more sharply on the second aspect of the solution: that is, how the city will be able to finance its ongoing operations after fiscal year 1978. Using round numbers, during the emergency period this financing need has averaged about $1 billion a year for long-term capital budget purposes—exclusive of borrowing to finance the city's annual deficits, a maximum of $2.3 billion in recurring seasonal loans, and an annual $800 million "bridge" loan between fiscal years. During this period, the long-term financing is being provided by the city's pension and sinking funds and by the Municipal Assistance Corporation; the seasonal requirements are being met by the Federal Government, and the $800 million bridge loan is being made by New York State.

At this time there is no indication of the extent to which the city will be able to meet these financing requirements in the capital markets. It would appear prudent, therefore, to make provisions for the contingency that the city may not be able to obtain such financing. It is in this context that I urge consideration of the Federal loan program that would make available any necessary city financing, but only on a standby basis. Last February when my comments were solicited on a draft of the General Accounting Office report "Assessment of New York City's Performance and Prospects Under Its Three-Year Emergency Plan," I recommended that the Federal Government consider enacting such a standby loan program.

The suggestion contemplates that the standby program would be in effect both for seasonal financing—the current Federal seasonal loan program is scheduled to expire as of June 30, 1978—and for longer-term borrowing needs—basically to finance the city's capital expenditures and those expense items which are being phased out of the capital budget pursuant to State and local statutes.

I believe that if prospective lenders were to be more confident in buying city obligations with the assurance that the city's full borrowing requirements would be obtained even if the city's aggregate cash needs could not be met in the open market, such a program would provide a more secure basis for the city's financial management over the next few years. Its enactment sufficiently in advance of the end of fiscal year 1978 should minimize the extent of its actual use, and it could even result in the standby loan never being used. The program should so result in the city's being able to borrow in the public market at lower interest rates than would otherwise be possible.

In closing, I would like to comment on the burden which New York State has assumed in including within its own seasonal borrowings the annual amount of $800 million for the use of New York City. This recurring loan, which has become a necessary element of the city's financing package, makes the State's own financing more difficult. It increases the State's seasonal borrowing requirements from $2.3 billion to $4 billion, and it impacts unfavorably on the State's overall interest costs. Comptroller Levitt recommends that the Federal Government give consideration to removing this burden. Thank you.

The CHAIRMAN: Thank you very much.

Governor Carey: If I may make a parenthetical comment for the record on the Comptroller's statement, we do incorporate in the State's future financial projections and budget expectations the necessity for carrying on the $800 million advance. It is not really a loan, but an advance on welfare reimbursables for which the city pays the interest.

The CHAIRMAN: Do you expect to continue that?

Governor Carey: For that advance, I see no other way.

I would not presume that Congress would undertake that $800 million since the State has proven that it can now carry that burden for the city and the interest on that advance is paid by the city.

The CHAIRMAN: Thank you.

Senator Schmitt: Senator Schmitt, Gentlemen, I appreciate very much this education that I am receiving about New York's problems. They are not completely unknown to me, as many of my constituents are former New Yorkers, many of them moving to New Mexico to not only partake in our sunshine and space, but to escape the taxes, as many of them say.

Do you foresee in the foreseeable future the possibility of a gradual reduction in real estate taxes once you are over this particular short term, hopefully short-term emergency?

Governor Carey: As for the State, I am able to say that with the cooperation of the legislature, we brought about nearly $300 million of personal income tax reduction for the people of the entire State and the first personal income tax reduction in the State on a permanent basis in 20 years in New York State last year.

The city is doing everything in its power to reduce the crushing burden of taxation that we now face. But there are constitutional limitations as to what can be done about the real estate tax.

Mr. Rohatyn has been working on precisely that problem with city officials, and I think he should speak to that.

Mr. ROHATYN: Senator, one of the problems with respect to the city's real estate tax structure is that it is used to pay off city debt. And I alluded earlier to the short maturities in the city debt, as opposed to the MAC debt. If we could restructure the $8 billion or so of city bonds which are outstanding and which, I think, now have an average maturity of about 5 years, on maybe a 20-year basis, it would permit the city—assuming its solvency is held to the grindstone, which is always a somewhat large assumption, but let's make that assumption for the moment—it would enable the city to lower taxes significantly, and, in effect, make that investment in economic development.

Senator Schmitt: That is the key, I think, is to be able to get the development program.

Mr. ROHATYN: Yes.

Senator Schmitt: Governor, you mentioned and probably rightly so, that welfare reform were two words that were part of the long-term key. Not only to the future of New York City, but any other major metropolitan areas.

Are you familiar with Governor Dukakis' experiments in trying to gradually tie welfare to employment programs?

Governor Carey: Yes. Governor Dukakis has worked strenuously to make changes in that system and relate employables on the welfare rolls to work programs.
Governor CAREY. That $6 billion is a low estimate, I believe. Multiply it.

Senator SCHMITT. Appreciate those comments; I am very sympathetic with them.

You mentioned not recovering from the recession of '37, we have some counties in New Mexico that haven't recovered from the depression of the '30s. I hope we can do something about that.

Governor CAREY. We sent you a great Governor from New York one time and he helped a little bit.

Senator SCHMITT. Yes, he did.

You mentioned the energy problem. I detected in some representatives of the so-called consuming States, of which New York could be considered one, a feeling that maybe some form of price deregulation of new oil or gas, domestically produced, may start to look more acceptable now that there is clearly not only a price problem but a supply problem. Would you care to comment on that?

Governor CAREY. You don't lose me on that one, Senator. I joined Senator Boren of Oklahoma—Governor Boren of Oklahoma—at the Governor's Conference in calling for phasing out the lid on new gas and new oil. I don't pretend to be an oil economist but I know that no product moving through the pipelines and no new product coming into market generally raises the price of the amortization of the price line. I strongly support deregulation of new supplies.

Then we should apportion those supplies so that we can get natural gas and fuel domestically which we need to keep our factories working.

Senator SCHMITT. I think you would find that under such a situation of just a new gas and oil deregulation, that within a few years I think it will not be possible for the person in the New York area to have the same type of price paid as the person in New York. I think it will take a few years until new energy alternatives become available.

Governor CAREY. I am the expert, but you have just given a fine expert from the State of New Mexico to the Federal Government in the person of Mr. O'Leary. I have heard his comments and I believe that his line is the one that you are enunciating right now.

Senator SCHMITT. He's flipped back and forth a little bit. I am afraid. I am not sure where he stands on new gas at the present time.

Governor CAREY. I know where he used to stand and I thought it was plausible.

Senator SCHMITT. Thank you very much, Governor.

The reason I did not refer to your illustrious citizens, Moynihan and Javits, is, I was assured they had no place else to go. So, I would yield.

Governor CAREY. My best to Governor Dukakis; he's doing a great job and we expect him in New York very soon.

The CHAIRMAN. Senator Moynihan.

Senator Moynihan. I would briefly thank the Chairman for his courtesy in inviting myself and my cherished colleague and to welcome the Governor and his distinguished associates.

I have three brief points to make, Mr. Chairman, and I can scarcely pretend they are of the order of questions, but rather comments. The first would be addressed to the question which is put to carefully and
correctly by Senator Lugar as to how one explains to constituencies elsewhere the special needs of our City and indirectly, the State.

I would simply make one plain point, but first let me say, I don't have any defense of the fiscal practices that led New York City to the verge of bankruptcy. No one does. In our politics there commenced to be something that was reminiscent of what Gibbon in the "Decline and Fall" called the schism of reality in the Roman Empire. That is a deep business and I don't know if you ever notice it. And I am not going to talk about it, but I will talk about one elemental statistic, which is that with only 0.8 percent of the population, New York State provides 13.3 percent of the Federal revenue. We contribute half as much as does the average State on a per capita basis.

What I hope, if and when we make special claims about special needs, such as welfare, is that the willingness we have shown to accept people from all over the country and provide them with a minimum standard, that willingness which has generated greater costs for us, will be recognized. We need greater participation by the Federal Government, much as desert regions need greater participation by the Federal Government in water conservation and development programs. I mean this is what being one Nation is all about.

But I would hope that it never reaches the point where New Yorkers have to conclude that the Federal Government is a bad bargain for us: that we really can't afford an active Federal Government. Because we pay half as much as we get, and when we ask for something that we particularly need, the notion comes, well, who are you to make such a claim.

On the second point, may I note that recently the first welfare reform proposal from the administration was the Food Stamp proposal. In a very familiar way, New York State receives less per capita than any other State in the Nation, and by way of reform, the administration proposes that it receive still less. And when asked how much less they say, nobody knows for sure, but less. Familiar.

On welfare reform I would like simply to say that I think the Chairman would recognize that if the Federal Government were to assume the costs of local contributions, why, the deficits you mentioned for fiscal 1979, 1980, and 1981 would disappear. At least they need not be there. They would be more than, much more than covered by welfare contribution.

I am sure the Governor would join me in acknowledging that President Carter made a solemn and specific commitment during the campaign that the Federal Government would assume local welfare costs made it in New York in the context of New York. I am sure the Governor would join me in saying that we do not entertain the possibility that this commitment will not be kept.

Governor CARTER. I totally agree with the Senator, on the record.

Senator MOYNIHAN. Lastly, sir, just to say that we think of New York as extravagant, and it is extravagant. It is extravagantly creative, an extravagantly wonderful place and if you haven't been raised on the streets of Manhattan, well, you have been deprived, that is all.

I would like to point out that we use two-thirds, our energy consumption in this great industrial, commercial city is two-thirds of the national average. Indeed, I think we learned in the press this morning that since 1970, there has been a 4 percent decline per capita in our energy consumption. We are careful in our expenditure of physical energy, but intellectual energy we continue to be extravagantly wasteful of.

Thank you, Mr. Chairman.

Governor CARTER. Senator, I hate to say it, but the energy conservation which resulted in New York City is endemic to the country.

When the factories are not working you don't use much energy. That is the kind of conservation we don't need. That is why the 4 percent drop.

Senator MOYNIHAN. But in the main the relationship, our having a lower per capita use in New York, is the case, is it not?

The CHAIRMAN. Well, it's based really—if the Senator would yield—it's based on the fact you have a far more energy-efficient transportation system rather than everybody coming to work by automobile in New York City, obviously you don't. You have a mass transit system that is much more efficient.

Senator MOYNIHAN. I thank the Chairman.

The CHAIRMAN. Senator Javits.

Senator JAVITS. Mr. Chairman, thank you very much.

Thank you again for having us here and giving us a chance to speak.

I think the point raised by Senator Lugar which has now been also answered by my colleague, Senator Moynihan, is the most critical, here in the Congress. The situation occurred in 1975, so I am glad the issue was raised.

I think it's critical. We are a big revenue producer. We produce about $20 billion in the income tax bracket alone in New York City. But beyond that we are characteristic of the great cities of the United States. And what happens to us is what is going to happen to them.

That is why we weren't allowed to go into bankruptcy. That is an awful big stake for our country. In addition, we are the transportation and communications hub, the services hub, the cultural hub, the medical hub. We simply can't be cut off and allow it to float out to sea. When the people of a river city fail to build dikes, and the rivers banks overflow, the U.S. Corps of Engineers come to their rescue. The same holds true for the TVA, Mississippi and Ohio Rivers systems. New Orleans Port and Los Angeles water supply and Hoover Dam as it does for New York's financial collapse. That is the reason.

That is why we are here and that is why we have every right to have confidence that we are not here in vain. This is the way in which the matter was handled in 1975, and we have certainly been shown by our performance that we don't take United States aid lightly.

How to do it? Governor, you and Mr. Rohatyn, who have rendered such unbelievable service far beyond the call to duty to our city, will be counseling with us and we will attempt to answer, how to do it.

I just don't think there is any one way, even as sent in the President's promise. It's quite proper for Senator Moynihan and the Governor to remind us of that, but it is in the highest interests of our Nation. That is our case, and that is what we have got to make stick here and you are helping us to do it.

Senator SCHERMER. Will the Senator yield?

Coming from a Western State, my thoughts are very much in line with Senator Lugar's. We do have to answer those questions.
Senator Javits. Absolutely.

Senator Seward. It isn't always quite enough to draw the comparisons, valid as they are, that you and Senator Moynihan have with respect to what one might call negligence sometimes or just need of western communities in the State.

What is going to be the critical factor for us to be able to explain to our constituents, that this is all right and proper, what the Federal Government does with respect to New York, is a growing and very visible improvement in the management of New York City.

I am encouraged by what I hear today, I hope that we will continue to be encouraged in this respect, because if we can go back to our constituents and talk with confidence that the corner has been turned and that the management techniques that are going to be applied now and in the future in New York City are in fact going to remove the problem, then I think you will see western support start to grow.

Senator Javits. Well, thank you very much, Senator.

I agree with that thoroughly. We have got to perform. We are in this shape, even though I think the equities are with us for Federal help. We have to demonstrate that we are doing more than our share. The American people believe in self-help and mutual cooperation, with great emphasis on both.

Thank you very much for your contribution, and I am pleased at the debate, it's the only way that you get any real action. I am not a bit resentful or unhappy.

We have to explain every step of the way, that is our duty and our pleasure.

Governor, one more question. It is a fact, it is not, that there still remains some things which can be done on the part of the Federal Government which are not directly in the current of direct help to New York?

For example, one thing that strikes me very forcibly is what is happening with the Drug Enforcement Administration. We are getting as the Comptroller General points in his report, Mr. Staats, in his very, very distinguished report dated May 2, 1977 for which as one New Yorker I am extremely grateful, states that New York, for example, gets out of about $560 million in Drug Enforcement Administration funds, etc., from various pocketbooks, 5 percent.

Now, right on its face it's unreasonable and ridiculous. New York is impacted with drug addiction more than any city in the United States. It's just inconceivable that the valid claim of New York, of about one-third to 40 percent of the drug addiction produces 3 percent of the Federal funds. That isn't exactly hay, that's big money. That's about $160 million as against $14 million. It makes quite a difference. Governor, from this report which bears out the contentions of the State and the city, may we expect the State to move vigorously into that area in terms of proper representation?

Governor Carey. Not only on drug abuse, Senator.

I totally agree that the money should be distributed as are the school aid funds—to where the potential recipients and beneficiaries live.

We are not confining it to drug abuse alone. Our State has taken the lead—expensively, but we think it's a wise investment—in combating alcohol abuse. Our attempt to contain growth of alcohol and toxic substance abuse among teenagers and small children is extensive and expensive but we are doing it.

We can't do more, because it's a major problem, which we cannot underwrite out of our State and local funds. But when I tell you that a low estimate of the number of hard drug addicts now you see back in New York City, showed there were over 150–200,000 on the streets in New York City, I'm not talking about alcohol now, I'm just talking about drugs—that is almost 10 times the number of persons in our total police force.

We can't win with odds of that kind against our police force in New York City. All those are, frankly, each one, a potential criminal because they can't afford the acquisition of hard drugs and they do turn to crime.

So if they are going to fight crime in this country, as every leader in our executive branch has always proclaimed, the way to do it is to help us contain the drug problem by putting the money where the addicts are.

Senator Javits. Thank you, sir.

One or two other things and I should be through.

The report of the Comptroller General also charts another area where it feels the State can help the city. Now, Governor, I realize that the State is doing fantastically by the city. I am not in any way that the State is doing fantastically by the city. I am not in any way.

The statement of the Comptroller General is that New York State's programs are considered the most liberal of any program in terms of eligibility standards.

Then it goes on to point out the enormous share of the cost which is borne by New York, and suggest a formula requiring the State to reproduce a greater share of the non-Federal match which would reestablish New York City of much of the financial burden of a program. It cannot control the cost since benefits and eligibility standards are established by the State.

It is the latter that I would like to fix the Governor's attention on as the money may not be available.

Governor Carey. No, Senator, in a recent budget adopted by the Commons, not only on drug abuse, Senator. Not only on drug abuse, Senator.
Then, of course, the loan will continue through 1977 and the first half of next year.

Nevertheless, I think that the attitude on the part of the Congress makes some sense, because of the strong feeling that we should not permit any city in this country to feel the Federal Government will be a lender of last resort and not matter what they do the Federal Government is going to step in and provide a guarantee or seasonal loan or some kind of relief or standby loan or whatever.

If we provide that standby loan for New York, then it seems to me we are in a position that we are being required to provide the standby loan for other cities.

Where do we draw the line? If you do that you lose your discipline. You just have to have it, it seems to me, some sort of feeling on the part of cities as well as States that they have to say no, they have to be willing to stand up against tough pressure to increase pensions and increase the pay and increase all kinds of things they would like to have in the city, but if they do, then they are going to be in trouble.

Senator JAVITS. Would the chairman yield momentarily?

The CHAIRMAN. Yes.

Senator JAVITS. I hope the chairman will not mind if I say I think, sure, you have got to be tough and make hard decisions, et cetera, but I don’t perceive the situation as discouragingly as stated in view of the distance which New York has come and the sacrifices which it has previously made.

I really, with all respect, think that there is a better chance to get help for New York from the Congress than that appraisal would indicate.

I think our colleagues are showing in respect to their consideration the formula and realizing that the pendulum has swung too heavily against our older cities and the northern part of our country, that they understand a thing or two beyond the parochial view.

I am really hopeful, Mr. Chairman, that you will look further into this question and have a little confidence in the fact that we do realize when people have sacrificed and strained, and that we are not quite as closed on that proposition as was indicated.

The CHAIRMAN. Well, yes, the reason I made the statement is because I wanted to set the scene for questioning Mr. Rohatyn on whether New York City can get back fully in the credit market after 1978.

You have expressed caution about that. You have expressed some concern, some feeling; it probably cannot.

But let me start with two or three things I would like to ask you about.

Mr. Rohatyn, you note in your statement that negotiations between the city, the banks, and pension funds earlier this year over repayment of the moratorium notes broke down. They broke down over the issue of establishing a long-term fiscal overseer for the city as a successor to the State’s emergency financial control board which goes out of existence as I understand it December 31, 1978.

You say you believe that establishing something of this sort is an absolute necessity for getting back into the long-term market; is that correct?

Mr. ROHATYN. Yes, Senator, I do.
The CHAIRMAN. Is it also needed for the city to do any short-term seasonal financing after fiscal 1978?

Mr. ROHATYN. For the next 134 years, I think the city has that, Senator, in that the emergency financial control board will be in existence through any foreseeable short-term financing maturities because it will stay in existence, I believe, until December 31, 1978. So you do have that mechanism for the short run.

The CHAIRMAN. I am talking about that expires after December 31, 1978.

Mr. ROHATYN. I don't think that is—

The CHAIRMAN. Will that be compromised by the absence of this kind of overseer?

Mr. ROHATYN. Short-term financing? It should not be technically, if the financial institution is willing to cooperate, and I think they should be.

The CHAIRMAN. Then you say we have our own view at MAC about the kind of mechanism that might be appropriate for providing some long-term fiscal oversight of New York City.

What are your views on that question? How should it be done?

Mr. ROHATYN. First of all, Mr. Chairman, we question, really, the need for a long-term basis to have two budding bureaucracies in effect—MAC and another review board in being for 20 years to compete with each other on how to criticize the city.

I think that MAC has a number of statutory powers which could be added to, and which could then in effect create a son of MAC, if you will, to stay in being for 20 years, and to perform that function.

We also feel that there is a difference in the powers that that board might be given during a period of fiscal balance—during which the power of that board might be limited to review and comment and public disclosure—and a kind of trip wire mechanism whereby once the city goes into deficit by more than, say, 2 or 3 percent of its budget, the MAC would be given the statutory power to require the city to cut its budget by an amount determined by it, obviously within priorities set by the elected officials.

In effect, we could envision a stop-go mechanism, whereby, as the city is in balance, the power is of revenue and review and disclosure; but once a trip wire is triggered and the city goes out of balance, the board would have the power to require budget reduction.

Governor Carey. Senator, if I may, Mr. Rohatyn really deserves the credit for the MAC acronym and he just mentioned son of MAC.

But let us be careful because whatever the instrumentation would be, it wouldn't be MAC the Knife. But it might well be MAC the Midwife which helps the city to deliver.

The CHAIRMAN. Then that would have to be the daughter of MAC.

Governor CAREY. I accept the amendment. Right.

Senator SCHMITT. Mr. Chairman, I have neglected, if I may interrupt to say that Senator Garn had some questions that he would like the witnesses to answer.

The CHAIRMAN. Without objection, if the Governor would permit, we will submit some questions to you for the record.

We are concerned about the MAC stretch. Suppose to save the city $200 million in fiscal 1978, Pension fund went along with it. Finally in 1977, the banks did not. Neither party has yet agreed for 1978. What has been delaying any agreement on that issue? Why are you hopeful that the negotiation with the banks and pension funds will succeed?

Mr. ROHATYN. As I understand it, what is delaying the issue right now is that the MAC stretch has been conditioned by the banks upon a simultaneous settlement of the banks' and the city's litigation with respect to their 10B3 cases, their liability cases in terms of the disclosures in previous offerings.

I am personally rather skeptical that that issue will be settled by June 1, which is when we have told the city we would like to see either the MAC stretch in being or alternative programs submitted.

The CHAIRMAN. When do you expect final agreement on it?

Mr. ROHATYN. I am not at all sure that that won't take some time, Senator. But I believe—and this is my personal belief I am giving you—that a resolution has to be found between the banks and the city and the pension systems on at least the first year of the stretch regardless of the settlement of these lawsuits.

[The Corporation submitted the following answer for the record:]

On June 1, 1977, the City announced reaching agreement with the Clearing House Banks, the Pension Funds and the City Sinking Funds for a "stretch" on terms that it projects will provide savings of $241 million in the 1978 fiscal year.

The budget as adopted by the City Council and Board of Estimate reflects this agreement and includes other minor adjustments to make up for the remaining funds originally assumed to be available from the "stretch".

The CHAIRMAN. What other problems need to be resolved in order for the city to get back into the credit markets?

For example, I understand the banks hold $418 million in short-term city notes which they agreed to extend in 1975 when the Moratorium Act was passed. However, when the court of appeals overturned the law, the banks petitioned the court to require that the notes be repaid as well.

Petition was denied without prejudice to further action.

Have the banks taken any further action to obtain repayment of those notes?

Mr. ROHATYN. No, sir. The banks are in the same position as the pension systems and I believe the pension systems together with the banks hold about $900 million of those notes.

This is my judgment that there will be a negotiation and those notes will ultimately be converted into some kind of city bond or MAC bond, and that the disposition of that issue will not be a particularly burdensome problem.

[The Corporation submitted the following answer for the record:]

As indicated above, the City announced on July 1, 1977, that agreement has been reached with the banks for a "stretch" of MAC securities for the 1978 fiscal year. As to the second question, it is likely that the Clearing House Banks will want to resolve the matter of the City Notes they still hold that were previously subject to the moratorium before resuming the City with any new short-term seasonal financing.

The CHAIRMAN. It has been charged that New York City clearinghouse banks sold off about $2.5 billion in New York City securities in 1974 and early 1975 without informing their customers that they knew the city was heading into a default situation.

There is a lawsuit pending on that matter and investigation by the SEC and State office of legislative oversight analysis.
Could that situation pose a problem for New York City's efforts to get back into the private credit markets in fiscal 1978 and beyond?

Mr. Rokatyx. You mean the existence of an ongoing investigation, Senator?

The Chairman. Yes, sir.

Mr. Rokatyx. Well, I would expect that a final report on the investigation ought to be forthcoming reasonably soon.

I don't believe that that issue itself is going to be a problem in terms of the city reentering the market. That issue really gets wrapped back into the issue of the lawsuits that the city and banks are trying to resolve in connection with the MAC stretch. But I don't think that particular issue necessarily has to be resolved.

The Chairman. As you know, the credit agreement pursuant to the seasonal financing requires, quote, the city uses its best efforts on an average July 1, 1977, this year, only 3, 5, or 6 weeks away, to meet the seasonal borrowing needs of the city without resort to Federal loans.

Last year the city came in for a Treasury loan of $500 million on July 1. Right after they had paid it back in full. This year's needs are expected to be about the same.

Will the city try to go to the market and raise that $500 million in late June or early July as the credit agreement directs?

Mr. Rokatyx. As far as I know, Senator, the city certainly intends to try to get the banks on board with respect to that issue very, very soon. Whether they can succeed in getting the banks' agreements to participate in that kind of financing as of July 1 is another matter.

The Chairman. And now I am talking about going to the market.

Mr. Rokatyx. They can't go to the market without having the banks on board on this issue.

The Chairman. If they get the banks on board—

Mr. Rokatyx. If they get the banks on board, it is no problem. If they don't get the banks on board, they won't be able to do it.

In my judgment—

The Chairman. See if I understand that. You are saying if they get the banks on board they will be able to go to the market and you won't have to borrow $500 from the Federal Government after July 1?

Mr. Rokatyx. I am sorry, I didn't say that would eliminate any need for Federal financing. I think if they get the banks on board in terms of creating a mechanism for commercial participation in the seasonal financing loans beginning July 1, they may in effect be able to lay off some of those loans on the banks and the private sector, but not in toto.

Again I question whether they will be ready to do that by July 1.

The Chairman. If the banks are not on board, what is the prospect?

Mr. Rokatyx. Then I think the prospect is very dim.

The Chairman. You wouldn't be able to go to the market for any part of this?

Mr. Rokatyx. That's right. But once the ECB has signed off on the budget, which is a precondition, there should be no technical or credit problem in having the commercial sector participate in the seasonal loan.

The Chairman. Then you think there is a pretty good chance the banks will be cooperative and, when would you be able to go to the credit markets for some of this?

Mr. Rokatyx. Again, I am giving you personal judgments. I believe that for some period of time the banks will probably still attempt to tie this particular issue—the issue of short-term seasonal financing—with the whole issue of the city bond and long-term overview.

As I said earlier, I believe that for a whole variety of reasons this may not be an issue that can be resolved before the fall because of the election race that is currently taking place.

The Chairman. Then you say in the fall you will be able to go—

Mr. Rokatyx. I would certainly think that would be the latest.

The Chairman. The GAO has suggested if the city is not able to reenter the credit markets in fiscal 1978, then MAC would be a potential source of funds for the city. Provided its debt limit were raised accordingly.

Since the States are responsible for their cities, as I have pointed out earlier, MAC would appear to be the logical vehicle for financing the city to the extent it cannot do so on its own.

Are you developing any contingency plans for enabling MAC to perform that role, if necessary, after June 30, 1978?

Mr. Rokatyx. Senator, we are currently looking at our own debt limit, our own coverage and our and the city's future requirements.

Obviously we may well go back to the State and ask for some lifting of our debt limit, provided, however, that we will stay within our coverage tests.

We do not want to go below a two-to-one overall coverage and the one and a half-to-one coverage on the sales tax for our first resolution bonds.

We have second resolution bonds where we have somewhat more leeway.

We will, first, try very hard to get our ratings back from both rating agencies. We are going to do some financing at the end of the month and at the beginning of next month to help the city out of this problem they have with Mitchell-Lama.

We will probably go back to the State and ask for some lifting of our debt limit.

The Chairman. I am going to run over my time to ask for two more questions because I think it is important to put these into sequence if Senator Davis permits.

Senator Davis. I have nothing.

The Chairman. You have done a marvelous job, I think the whole country, as well as the city and State of New York owe you thanks for the fine job you have done, for restructuring the Federal burden, but it's been charged that you have been too generous in the terms you have offered investors at high expense to the city.

I realize you don't want to take a chance on failure but the recent MAC exchange offer for moratorium did sell out for $100 million, that is not too surprising when you were offering 9 3/4 tax-free interest rates, meaning a yield for a 50 percent income bracket of about 20 percent.
Furthermore, you record $8 million in fees paid for marketing the swap power. What is your defense against the charge that that is excessive?

Mr. Rohatyn. Well, Senator, may I just take 2 minutes and take you through how we did the exchange offer and then you will see that I don't need any defense.

We wanted to sell $500 million of MAC bonds publicly and in December we were told we could do it at 9 percent. We went to the banks and we went to our investment bankers and requested them to underwrite an issue. The banks said: “Gee, we are very sorry; we can't underwrite your issue as long as the constitutional case has not been decided in the Court of Appeals.”

We went to the investment bankers who said, “Gee, we don't think that case is very troublesome but we can't underwrite your bonds as long as the banks won’t.”

We went to the Court of Appeals and asked them to accelerate the case and they said, “Gee, we are very sorry; we can’t do it.”

In the meantime, the city’s plan to refinance the billion dollars was beginning to fall apart because the Mitchell-Lama program was lagging.

We called our investment bankers back in to advise us on the rate we would have to put on an exchange offer, since we didn’t have underwriting available to us at the time.

The public marketplace seemed to indicate that by then, around 9 3/4 percent was probably a double proposition, since we had lost the December market.

Our investment bankers said we would have to put at least a 10 percent rate on the offering in order to have a chance of success. We asked them if they would be willing to act as our agents in an exchange offer, even though we weren’t willing to pay that rate. They said, no, they would not be willing to do that unless we paid at least 10 percent, and also put us on notice that if we failed in our exchange offer, the State’s financing—which was coming in three weeks later—would be put in jeopardy. With that they wished us luck and left the room.

I called the Governor and told him of the notice that we had been put upon and also told him that it was our advice that we should not do 10 percent.

But to be on the safe side, since we couldn’t afford a failure, even though the market might indicate 9 3/4 percent, we would be prepared to go to 9 3/4 percent—provided that we would shorten the period during which we couldn’t call the bonds from 5 to 3 years, so as to shorten the period during which these bonds would be a burden to the city.

Since we didn’t have an underwriting group that was willing to work with us, we took the commissions that we would have paid the underwriters for effect, allocated them to the broker/dealers who would bring the notes in.

The Governor, who was both charming and courageous, told us that if our judgment was to go to 9 3/4 percent, he would stand by us, although he’d be put on notice that if we failed the State would fail. And so we closed our eyes and held our nose and jumped out of the airplane and it was a very lonesome, cold and wintry feeling out there because everybody walked away from us. We did get—
Mr. ROHATYN. Invoking parts of these items that are in our expense report, yes, sir.

The CHAIRMAN. So that it would have been higher still it hadn’t been for the State—

Mr. ROHATYN. Yes, sir. I will be glad to join any crusade, Senator, in terms of lowering legal fees and reducing the amounts of the time we spend with batteries of lawyers.

Governor CARY. If I might, Mr. Chairman, as a member of the profession but no longer actively practicing, I do think that Senator Javits, distinguished member of the bar of New York State, would agree, you can hire less lawyers for a lot less. We couldn’t afford to lose these cases.

I have never seen such ingenious and, frankly, innumerable matters of litigation that were generated because of the very existence of MAC. And the case law has overloaded our court of appeals and we have had to expedite decisions. I am not making a plea for justification of fees in high amounts, but, very frankly, if we went out shopping for bargain lawyers we might have lost some of those cases.

We had good representations, we had to pay for it.

Mr. ROHATYN. I would like to support that statement, Senator. We have three sets of lawyers on a regular basis.

Senator JAVITS. Who are they?

Mr. ROHATYN. Paul, Weiss, Rifkind, Wharton & Garrison, general counsel for MAC. Hawkins Delafield & Wood, who are bond counsel. Then we pay for the counsel for the trustee of our bonds. Carter, Ledward & Milburn. Then occasionally, as part of the negotiations with our underwriters, we have the right to get a portion of their expenses.

I believe our general overhead at MAC is only some $500,000 annually.

The CHAIRMAN. Do these lawyers ever do this pro bono publico?

Mr. ROHATYN. Well, Senator. I believe many of the lawyers have indicated that they are doing it at less than market rates, and some of them are doing it on an individual basis, pro bono. That is the last answer I can give you.

Senator JAVITS. Mr. Chairman—

Governor CARY. All those fees are actually taxable income in New York State.

[Laughter.]

Senator JAVITS. I would suggest—we get some of our money back.

I think I understand the situation, having myself headed a large law firm, in terms of the hours spent.

Therefore, I would suggest to the Chair that, as a rough measure of value, we have some estimate of the number of hours and costs by the various firms at the various echelons of charge, that is, juniors and senior lawyers, partners.

The CHAIRMAN. Good idea.

For the record, could you give us that?

Senator JAVITS. I think that will be helpful to the city and the State because in a case like this, it is a fact that an enormous number of people have to be put on it for very considerable periods of time including weekends and nights, and it gets very highly pressured.