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Transcript of Proceedings

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

HEARINGS ON

NEW YORK CITY FINANCIAL AID LEGISLATION

Washington, D. C.

Wednesday, June 7, 1978

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United States Senate,
Committee on Banking, Housing,
and Urban Affairs,
Washington, D. C.

The Committee met at 10:40 a.m. in room 5302, Dirksen Senate Office Building, the Honorable William Proxmire,
chairman of the committee, presiding.

Present: Senators Proxmire, Sparkman, Sarbanes and Heinz.
Also Present: Senators Moynihan and Javits
The Chairman. The Committee will come to order.

We scheduled the hearing to begin at 10:30. Unfortunately, I was delayed and I understand the Governor hasn't arrived as yet, but we do have a distinguished, outstanding expert. I suppose he's as expert in these matters as anybody in the country and we are delighted to have Mr. Felix Rohatyn as our first witness. Mr. Rohatyn has a statement and we will be happy to hear from him.

STATEMENT OF FELIX G. ROHATYN, CHAIRMAN,

MUNICIPAL ASSISTANCE CORPORATION.

Mr. Rohatyn. Thank you, Senator.

(Complete statement follows)
The Chairman. Thank you, Mr. Rohatyn. The Governor hasn't arrived. I've got a number of questions, as do other members of the Committee perhaps, so it would be an opportunity to get into these.

You have outlined to us a financing plan which you think New York City should follow over the next four years using federal guarantees. I don't agree with it but I'd like to know how much of it is in place to date. What type of commitments do you have from the banks and pension funds to invest in the city or MAC obligations either unguaranteed or guaranteed? The mayor told us yesterday that the banks have made an unconditional commitment to purchase $500 million. Is that correct?

Mr. Rohatyn. No, Senator, that's not correct.

The Chairman. What are the conditions?

Mr. Rohatyn. There are nine conditions, Senator.

The Chairman. Will you give us those conditions?

Mr. Rohatyn. Certainly. Most of them haven't been met.

The Chairman. Most of them haven't been met?

Mr. Rohatyn. Most of them haven't been met. The first condition was the Emergency Financial Control Board extended with appropriate powers and life. We are still negotiating with the banks with respect to the sunset provisions of the EFCB so that condition has not been met.

The second is federal legislation passed with $2 billion of long-term guarantees. I don't need to elaborate on that.
Third is provision for short-term needs assured, and then there is a statement by the banks that it is not contemplated that this would involve the clearinghouse banks. This is clearly not our view. Any short-term financing will involve the clearinghouse banks. That is an open item.

Four, a balanced budget for fiscal '79 and financial plan approved by the EFCB, and Mr. Kummerfeld is here.

The Chairman. Balanced budget for fiscal '79 according to generally accepted accounting principles?

Mr. Rohatyn. Sir?

The Chairman. You say fiscal '79 according to generally accepted accounting principles?

Mr. Rohatyn: Fiscal '79. Is that on the basis of adjusted principal, Don?

Mr. Kummerfeld. Yes. We have had discussions with the banks. They do not require a balanced budget in '79 on GAAP principle basis; rather, on the basis of uniform system of accounts as modified. That means there could be $450 million of capitalized expenses in the fiscal '79 budget.

The Chairman. In other words, they could have, on the basis of accounting principles, a $450 deficit?

Mr. Kummerfeld. That's right.

Mr. Rohatyn. Number five is pension fund complete purchases under the '75 agreement. That is clearly not complete.

Number six is other participants in the MAC four-year
long-term financing in place, insurance companies, savings banks, public pension funds, not complete.

Seven, MAC funds enjoy investment grade rating. That's the only condition so far that seems to be in place.

Eight, unguaranteed MAC securities offered to the clearinghouse banks must be the same as those accorded to city pension funds and other institutions. I don't think that's a problem.

Nine is the same conditions and tests for the subsequent takedowns. I'll give the Committee copies of these conditions, Senator, if you would like me to, but the long and short of it is we do not have unconditional commitment from anybody.

The Chairman. That puts us in a -- even those who do favor going ahead -- puts us in a kind of difficult position. Aren't we buying a pig in the poke? Do we really know what we're doing? We're moving ahead in this area when most of the important conditions are not met.

Mr. Rohatyn. Well, Senator, I think that we just haven't been able to move with all of these parties, especially the city pension funds.

The Chairman. As you know better than anybody, on June 30 the legislation expires and if these conditions are not met what happens?

Mr. Rohatyn. Well, first of all, on June 30 we have a rather interesting situation building up in that we have barely raised enough money to see the city through the end of the month.
Yesterday and I guess this morning we will be selling 24-day MAC notes to the city pension systems in the amount of $350 million roughly. That amount of money plus the real estate tax should see the city through the end of the month. However, if at the end of the month the city pension systems --

The Chairman. Through the end of what month?

Mr. Rohatyn. This month, Senator, June. We have set a record of making the shortest public financing on record for a municipal assistance program. At the end of the month we have taken the position and continue to take the position that we have a legal commitment from the pension systems to purchase $700 million of city bonds by the end of fiscal 1978. We have a legal opinion to that effect. We have a draft complaint in case they don't do it, but the draft complaint won't produce money.

The Chairman. Mr. Rohatyn, I have a number of other questions along this line. I'm sure other members may have questions for you, too, but since the Governor has arrived, we will proceed with his statement.

Governor, go ahead as you wish. We are delighted to have you. You are a noble man with a tremendous responsibility. You appeared before this Committee before in 1975 and you have appeared since then. You have always greatly impressed us and we all have great admiration for you. Go right ahead.
STATEMENT OF THE HONORABLE HUGH L. CAREY,
GOVERNOR, STATE OF NEW YORK.

Gov. Carey. Thank you very much, Mr. Chairman.

I begin with an apology for my belated arrival. Our takeoff from the capital airport in Albany and the state airport was timely but I was held at the national level coming in. I hope that's not an omen for the future of our state.

The Chairman. That's not a harbinger of things to come I'm sure. Maybe I wish it would be but --

Gov. Carey. Thank you, Mr. Chairman.

(Complete statement follows)
Gov. Carey. I come before you, Mr. Chairman, not representing a state which is a "junkie" looking for federal aid. No, we come before you as a state that's strong enough to have endured the most critical condition that's ever been forced upon a major city in our country. The results of the condition we met and we have been dealing with. The result we seek is to be free, to be free of the dependency that was forced upon us because excesses of the past had to be dealt with. We have dealt with those excesses and I can tell you, as chairman of the Control Board, to continue that body with stringent powers is to willingly undertake a year-long siege of hayfever while wearing a hair shirt. We are willing to do all these things and I assure you, being Governor of the State of New York at the same time as being Chairman of the Control Board is an unenviable position, but it's necessary to fulfill that responsibility and I stand ready to undertake the duties of the Control Board to work with the mayor, to work with our state legislators and the city officials and all others involved to bring forth in New York for the benefit of that city, our state and this government of the United States the kind of hope to which our people are entitled.

No, we are not "junkies" and we are not that kind of a state, Mr. Chairman. We have been healthy and we are seeking to regain our health and we are doing it by putting ourselves through rigorous physical regimens that help to add to the
strength and stamina of a people. So we come before you with
strength and stamina and all we seek is the kind of, yes, the
kind of marathon exercise that will give us the long-term
stamina we need. We are not out of breath. We haven't lost our
way, but the idea of nursing us along on hand-to-mouth feeding
as represented by seasonal borrowings will only keep us in the
condition which I know you want to end and which I want to end
for the people of New York State.

The Chairman. Governor, thank you very much for a very,
very strong and impressive statement, but I want to challenge
that statement because I think it demands challenging.

What you're really telling us is New York City and New
York State has done all it could do and all it could be expected
to do. I'm not sure it has. I think you can do more and the
city can do more and a great deal more than it's done. Once
again, I want to preface my question by explaining how convinced
I am -- and I'm sure you are, too -- that the states are
sovereign. The states have sovereignty over the cities. The
city is the creature of the state. The state can abolish it,
recreate it, expand it, contract it, whatever it wishes to do
with a city. The federal government, of course, is removed from
that. This is why New York City is the only city in the country
that's gotten this kind of federal assistance and it's gotten
it once and now you come back and ask for additional assistance.

You come back and ask for it also at a time when you're
reducing your taxes by $750 million. Back in 1975 it was proposed by then Chairman Burns of the Federal Reserve Board that New York State ought to have a substantial tax increase and use that money to help meet its problems.

Gov. Carey. And we did. We increased the taxation on the citizens of New York by $200 million as a condition to securing federal aid. We put on emergency taxes to balance the state budget pursuant to our agreement with the federal government. But as soon as we could do so we removed those taxes as far as the state is concerned. We have not removed the tax from New York City.

The Chairman. That $750 million tax cut is not just a removal of -- I think it's good. I think we need a tax cut. What happened yesterday in California and Ohio tells us that the people are fed up with high taxes and they are insisting that those high taxes be reduced.

Gov. Carey. Mr. Chairman, you make my case. New York State has the highest taxes in the country and even after that tax reduction we still hold that unenviable position.

The Chairman. It's essential for the United States to ask what kind of case the state is actually making in this case. Therefore, I'd like to get down to details here. The state commitment to provide additional, recurring state aid to help New York City balance its budget in fiscal year 1979 and in subsequent years I'm concerned about. I know you say that the
state is providing $250.5 million more in 1979, but a close
examination of that aid package raises some serious questions.
Only $134.5 million of the $250.5 million total represents a
real increase in funding for New York City which the state is
presently obligated to provide: $75 million more in state
revenue sharing, and $59.5 million more in education aid. The
second largest item, $60.5 million from state assumption of
local SSI costs starting October 1, is contingent on the funds
being available to the state from an extension of federal
countercyclical aid, so it's really an item of federal aid, not
state aid. More importantly, the Administration bill now
pending before Congress would eliminate funding to the states,
so there is reason to doubt whether that $60.5 million will
actually come to the state.

What if you don't get that money? Will the state come up
with the money from some other sources, or will you leave the
city with a gap $60.5 million hole in its budget for SSI?

Gov. Carey. The answer is we have never left the city with
a gap in its budget. Whenever the federal government has failed
to renew a commitment to us we have substituted it with state
effort. The record will show from 1974-75 through the projected
budget of 1978-79 the increase of state aid on a total basis
from state sources alone to local assistance has gone up by
23.1 percent. The kind of funds you're talking about from
countercyclical we have not applied those to state purposes
which we could have done. We added them to the local assistance
budget of the state to New York City and other localities. Including those figures the increase to localities have gone up by 36.9 percent.

The Chairman. In other words, what you're telling us, in the event the federal government doesn't come through, you will?

Gov. Carey. Yes. We can point to the fact the formulas in education, the formulas in health, the formula aid we have in various mental hygiene, the formula in local aid, is such that we will plug these in and they extend on out to show, if you read them very carefully they are there, and we can adjust those formulas and are capable of adjusting those formulas to make up for any shortfalls that comes from the federal government.

The Chairman. Now another $55.5 million of the state aid package is sort of a grab-bag which does not really represent additional, recurring state funds. Instead, it consists of a $22 million one-shot revenue, plus some savings from management efficiency totaling $21.5 million which presumably you should do anyway, regardless of the City's needs, since it helps you and helps other localities in the state. Then the final $12 million will come from the state's permitting the City to increase its tax revenues by levying property taxes on certain Conrail properties.

It seems to me that state aid to the City should be much higher, and that there should be more real, recurring money to help the city provide essential services. Instead, you passed a
$750 million state tax cut. Shouldn't the state do more to help the city?

Gov. Carey. If you look at the budget of the State of New York, which is about $12 billion, compared to the city's $14 billion, the first principle is that the state budget for the entire state is smaller than the expense budget of the city itself. So while we can talk about the city being the creature of the state, New York City is a much larger entity than the state budget itself in fiscal terms.

With regard to state aid, we have undertaken -- and it's important to see that these programs are increasing and moving consistently ahead -- a greater share of the funding of the city university, a greater share of the funding of the court and we propose in our negotiation with the city on correctional institutions for acquisitions there. We have as well increased and propose to increase more the state's share of aid to welfare clients because as the state moves down and has already increased its ineligible ratio we will increase that.

The Chairman. Let me get into that subject. New York City's principal budget problem is the more than $1 billion it pays out each year to cover the local share of welfare and Medicaid imposed by New York State. Without this burden, its budget might be balanced.

Gov. Carey. No, we don't impose the local share of welfare and Medicaid. The federal government determines what the share of Medicaid will be.
The Chairman. The federal government provides for part of the cost.

Gov. Carey. I was here when we passed the Medicaid bill.

The Chairman. The state provides for others. New York State is only one of thirteen states in the country which impose any local share for these programs and the local share in New York is 25 percent, by far the highest.

Gov. Carey. Those 13 happen to be very large states with very large Medicaid populations.

The Chairman. Your share in New York is by far the highest, much higher than California, a very large state.

Gov. Carey. And we increased the state share of Medicaid support in this past year and we have further led all states in cutbacks in Medicaid which go to the benefit of local as well as state payers by an enormous amount. Secretary Califano will tell you we led all states in terms of Medicaid cost containment reduction. We were ranging upward at the rate of 26 percent a year.

The Chairman. Yet you still have the largest burden on New York City of any city in the country because the state, unlike other states, does not assume the highest proportion of the aid. The federal government provides the same everywhere. If you wanted to give more aid to New York City this would be the way to go. Cut down the local share of welfare and Medicaid because the city alone bears over 70 percent of these programs.
Gov. Carey. Among the states you cite, none of those other states have what we have in New York. If you look at the total budget construction of New York State, you will see, with the exception of $5 billion or less, all the monies in the state budget go to the aid of localities and about 50 percent of that goes to New York City which is about half the size of our state. New York State, for instance, takes 18 percent of its total percentage in income tax collections and hands them over in terms of revenue sharing to the localities. If we just took that 18 percent and substituted it for the welfare share we'd be not among the 13 states. You'd have only 12 states.

The Chairman. In Wisconsin we hand over 50 percent of the state income tax to localities.

Gov. Carey. How much is your income tax?

The Chairman. It's just about as high as New York State. It's very, very high. Wisconsin and New York lead the rest of the country in progressivism in almost all respects. I see my time is about up, so I did have some time before so I yield at this time to Senator Heinz.

Senator Heinz. Thank you, Mr. Chairman.

I'd like to ask Mr. Rohatyn a few questions. I regret that I wasn't here for your testimony, but I do see that you address the difference between short-term financing and long-term financing and I will try and digest that at my earliest opportu

But one thing I do note is that you feel that of the
$2 billion that the Administration has suggested in guarantees, that you feel the city would only need $1 billion of that.

Mr. Rohatyn. No, Senator.

Senator Heinz. Could you elaborate on that in greater detail? More importantly, if that's true, why should we give the Treasury and, for that matter, New York City, an extra check for $1 billion of guarantee that they don't need?

Mr. Rohatyn. Well, Senator, the fact that the second billion is not issued right away but is kept as an insurance policy against future market access failure, nonetheless, still makes it an integral part of the plan. The fact that you may never use it, like an insurance policy, doesn't make it any the less vital.

On the contrary, I think without it you don't have a viable plan. What we tried to construct was a plan that would follow along the lines of what Secretary Blumenthal was trying to construct which is a plan which would in effect reduce to a minimum the actual committed guaranteed parts of obligations and create a maximum incentive for local participation. It would be much easier for us to use the $2 billion up front but it wouldn't create the incentive and the pressure to bring the city back to the market. Therefore, we determined that as a practical matter we thought we could get by, although as I told Senator Proxmire before your arrival, we have no commitments for the total parts of this plan. I might liken it to almost a spare wheel on an
automobile. It really ought to be there in case you have an accident. Otherwise you really don't have a complete structure. The fact that you may not put it on right away doesn't make it any the less vital. It means, however, that you might never use it, and that this is what I indicated later on in my testimony, that if this plan works as I think it may work you might wind up with in effect only having used a billion dollars of the guarantees, which is maybe 15 percent of the total financing that is structured here, which is really a sharp reduction from where we have been and probably a sharp reduction from the amount of money that you would put up if you were just extending the seasonal loan.

I would like to further differentiate between seasonal loans and guarantees in that were you to extend the seasonal loan, which in my judgment is a program which would -- if it worked at all, it would simply bring the Governor and the Mayor and the MAC Chairman back here two or three years from now; but it means also the Treasury has to go out and raise cash while the Treasury is already financing huge amounts of money and beginning to crowd out other borrowers. Why put another $2 billion pressure on the Treasury? The Treasury would have to raise or put in the city and the city would have to pay back and start all over again when we really don't need that.

The guarantee, Senator, in my judgment, and from a purely financing point of view, is technically the right way to finance
this structure. Now it may be emotionally, morally, politically --
for all kinds of reasons -- not doable, but if you're looking at
this thing purely from a financing point of view, which is the
way I think it should be looked at, and if you will accept the
proposition that there can't be a loan that's bad for us and
good for you because the thing has to fit as a rational whole,
then what I submit to you, Senator, is that the guarantee route
is cheaper, less risky, involves less cash commitments by the
federal government, and will get you and us out of this exercise.

Senator Heinz. Well, as you are aware, it would set a
unique precedent for the federal government to guarantee the
obligations of a state instrumentality.

Mr. Rohatyn. Senator, I know very little about precedents,
but may I just suggest one or two things?

Senator Heinz. Well, let me just finish for the moment.

Mr. Rohatyn. I'm sorry.

Senator Heinz. It is true the federal government guarantees
all kinds of things. Mayor Koch was before us yesterday and
noted that the federal government has a considerable amount,
over $300 billion worth of loan guarantees outstanding, but
nonetheless, it is also equally true, as Governor Carey well
knows because he has a clause in the constitution of the State
of New York he has to contend with, that the units of local
government, state instrumentalities are the creation of states
and in New York State, unfortunately, I think there is a
prohibition in the constitution which prevents the state from assuming what you might call any long-term credit obligations, liabilities or underwritings for state instrumentalities. I would only note that I believe within the last two years the state was asked to consider changing that portion of the constitution so if we got into a situation like this where a financing alternative was the best alternative, and I have no doubt from a financial man's point of view this is an excellent alternative that we would be in a position to let the state, which under Governor Carey's leadership has been doing very well -- and I commend you for the tough job but the excellent job, Governor, that you have done in bringing New York State into a position where you can actually cut your taxes $750 million as I understand it -- I think every state is now competing with you. California is trying to compete with you now with Proposition 13. You may not have been able to go that far, but you started the ball rolling.

But the result is that we're in a position now where because of the New York State constitution it appears that absent the change that New York State can't do what would normally be the more or less appropriate thing to do here.

Do you have any comments on that?

Mr. Rohatyn. I'd like to go back for a moment to the -- Senator Heinz. Then maybe the Governor would like to say a word.
Mr. Rohatyn. I would like to go back to the long-term financing versus seasonal financing and the precedent.

First of all, the guarantee as a practical matter is an alternative to a long-term loan and the reason we want guarantees partly is because it's an off-budget item. Long-term loans or guarantees are exactly the same in practical financing.

I think that as a realistic matter a seasonal loan that gets rolled over and over again because in the last analysis it doesn't do what it's supposed to do becomes a long-term loan. Now whether it becomes a long-term loan after six years or nine years or ten years, once you cross the bridge of financing that by the realities of its nature it's long-term financing. We can't pretend that these past deficits that have to be funded are really short-term financing items or capital items.

Then you're really talking form or substance. I think you are in an area of long-term financing now through a seasonal loan that is going to get rolled over. It's going to get rolled over, if it does, because it's easier probably philosophically than doing a guarantee. So it's long-term financing and therefore will not get you out of this situation as quickly as it might otherwise.

In the '30s, the RFC bought a lot of long-term bonds of municipalities that were having difficulties. So in terms of the federal government being in the area of long-term financing to municipalities that were having difficulties, I think the
issue of precedent strikes me as much less troublesome than the
issue of what is the right way to finance this to get the federal
government and the city out of it.

There again I would strongly urge you to consider that the
guarantee route can be structured both substantively and tech-
ically in a way to get you out better and cheaper and quicker.

Senator Heinz. Well, let me pursue two things that you
have mentioned. Ultimately, the ability of New York City to
meet its own credit needs is going to depend on Mayor Koch's
success in meeting the four-year plan goals, getting to a
balanced budget by generally accepted accounting principles
at the end of four years.

Now I think it's reasonable to assume that if New York
could make it on a day-to-day basis sometime between now and
that fourth year New York would, based on that performance in
that plan be able at time "x" -- maybe it would be the end of
the fourth year or the beginning of the fourth year, maybe
three and a half years -- we don't know -- would be able to
enter the conventional financing markets.

My question to you is, with the guarantees that we have
here, what is the difference in that time period? When would
New York otherwise be able to enter the bond market on its own
without the guarantees but with seasonal financing?

Obviously, I see my time has expired -- obviously under
this plan they are able to do it assuming that the bank conditions
et cetera can be met, they are able to do it quite promptly.

How much longer would it take New York to do it on its own?

Mr. Rohatyn. Assuming a seasonal financing plan?

Senator Heinz. Yes.

Mr. Rohatyn. I would have to take you through the numbers in the back of my testimony, Senator, but to just do it in kind of summary form, if we were able to put together a financing package around seasonal financing -- and I'm not saying that we can because I don't know -- but if we can, it would probably take the following form: we would take this $4.5 billion plan and chop off $2 billion. We would chop off the billion that's guaranteed because obviously that would be gone, and we would chop the back-end billion of city bonds with federal guaranteed standby because I don't think they would work.

So we would be down to about a $2.5 billion plan over say a three-year period which would be based purely on MAC financing and on the assumption that MAC will have that kind of market access on its own without seeing the light at the end of the tunnel, if you will.

Now that means also that we will be cutting back on some of the financings that are in this plan that are required to bring the city into balance more quickly and that are things if we don't finance them will either keep the seasonal requirements higher and therefore impede the city's market access or will increase the city's deficit and therefore again retard its
reentry to the market because its budget balancing will be retarded. So you will be embarking on a course where you will be providing more cash than we are asking for because we are not asking for any cash. You would probably have to provide $2 billion. And at the end of three years, if MAC had that kind of market access and were able to finance, we would have MAC at $8.5 billion of our $9 billion.

Now bear in mind, Senator, that the State of California is today the largest long-term municipal borrower in the United States with $6 billion. We would be up there with $8.5 billion and last December you will recall we ran into a lot of trouble with the $250 million issue.

Senator Heinz. Those were city?

Mr. Rohatyn. Those were MACs.

Senator Heinz. That's right. Those were MACs.

Mr. Rohatyn. We do not have unlimited market access, no matter what our credit ratings, no matter what our credit standing. My prognosis is, or at least you ought to consider, the probability, that you would get at the end of another three-year program with MAC having blown most of its borrowing capacity at that time, with the city still not being in the market because we would not have refinanced large aspects of its requirements, and you would be faced not with the likelihood of somebody asking for a billion dollars of guarantees up front and a billion on standby, but you might be faced with a requirement of
$3 or $4 billion because the city still would not be in the
market and MAC would have shot its wad.

Now this is a summary, if you will, and I will be happy to
take you through it at any time, but this is a technical issue,
Senator, and this is why I say to you this is a better way to
finance from your point of view as well as ours.

Senator Heinz. Well, my time has expired. I would only
state that I think it would be appreciated, not just by myself
but by the members of the Committee, to see how, if we go for a
three or even a four-year seasonal financing plan, the cash
requirements of the city would change, its deficit would change,
the extent to which you would have to come to the federal
government for additional seasonal financing would change. I
think that is a very helpful analysis and it's one by the way
that I asked Secretary Blumenthal to provide several months ago
and I understand there's a chance he may have it for me this
afternoon.

Mr. Rohatyn. We have a smaller staff than the Treasury,
Senator, but we will try to provide it.

Senator Heinz. Maybe you and the Treasury should work
together. I thought you had been a little bit.

Thank you, Mr. Chairman.

The Chairman. Senator Sparkman.

Senator Sparkman. Well, Mr. Chairman, I want to say that
I have listened with great interest. I have been very much
impressed, Governor, by the presentation that you have made to us and I'm sympathetic with the appeal that you gentlemen are making and have been all along. We had this up as a preliminary matter you may remember two or three years ago and I thought at that time we would be able to work out something. As I say, I am impressed with it, but still I wonder about some parts of it.

Now $2 billion is the total sum, isn't it?

Gov. Carey. The guarantee part.

Senator Sparkman. The guarantee part, yes. When would you expect that money to be paid back to the federal government?

Gov. Carey. Well, the answer is, Senator, that if all things work out -- the guarantee provision is reserved -- it might not be tapped. In other words, it might not be drawn down. So the period of the guarantee exposure for the federal government, if that's what you mean, would be 15 years. The exposure to the guarantee is up to 15 years, but whether or not we would draw upon it would depend upon how well we monitor and how well we do in terms of access to the marketplace and the conditional commitments that Mr. Rohatyn has been able to achieve. In other words, instead of the seasonal borrowing -- we do need some seasonal, but we move down on the seasonal and assuming our ability to handle our affairs as we have shown we can handle our affairs, the presence of the guarantee system as a backstop for us is what we're seeking.

Now the answer is 15 years at the outside for the exposure of the federal guarantee.
Senator Sparkman. And you're confident that your troubles can be worked out and the government be repaid?

Gov. Carey. I'm as confident as I am that the other programs where guarantees have been put in place can work as they have in the guaranteed housing program for limited income housing which attracts guarantees from the federal government. I believe that system of housing supports came through this Committee and is working. The same programs of guarantees are available to localities for sewage disposal construction and are in place and are working, and those guarantees are enforced and are met.

A good example might be the guaranteed student loan program. Our state leads in terms of the use of the guaranteed student loan program to finance students through our great state universities and our private institutions. If those students had to depend upon seasonal borrowings to pay their tuition and repay it in a limited time frame such as four or five years, we wouldn't have them in college because they couldn't afford to do it. The guarantee allows them to pay back the student loan over extended periods, like ten years, and we finance students through higher education and they pay back that tuition money out of the earnings that they have received and the taxes they pay.

So there are precedents clearly in place that are valid for the use of the guarantee system as a backstop and a way to extend
the ability to pay and at the same time keep in place a regimen
that secures that ability to pay. Housing, education, and the
environment.

Now we're asking here to a limited degree that it be used
to assist the city get on a sound basis, on a permanent footing.

Senator Sparkman. Well, let me say that I believe strongly
in the guarantee program. In fact, I introduced legislation
regarding it. I introduced the legislation, for instance, to
guarantee college housing and billions of dollars have been
spent on that and it's been a great benefit to the educational
system of the United States. I was rather shocked when the
President proposed the discontinuance of that program, and I
can name other guarantee programs that we have had. I believe
strongly in the guarantee program.

But we also want to be sure that it will be fiscally
sound and I believe from what both of you have said that it
seems to me that you have worked out in your minds a sound
program and I certainly hope to be able to support it.

Gov. Carey. Thank you, Senator. Let me say by way of any
endangerment that the guarantee program would spread and become
a magnet that would draw other cities to Washington, I want to
respond to you, but in part it's a response also to a concern
expressed by Senator Heinz. The answer as to why it's not going
to be that magnetic and draw the cities and states to Washington
is that I offer myself as a consultant to any state that wants
to go down this road as to what it means to have the Governor administer state functions and at the same time serve as chairman of a control board in a major city. I don't think you're going to find it to be such an attraction that Governors will be rushing in to undertake those kind of responsibilities. I can swear that it isn't that kind of attractive system. It's one you have to endure if there's no other alternative and that's why New York had to endure it.

Senator Sparkman. Thank you.

The Chairman. Senator Javits.

Senator Javits. Governor, you've got another challenge like the one that you met in '75. I'm glad to see you're addressing yourself as manfully to this one as you did to the last one.

I'd like to ask you about the alternative. We questioned Mayor Koch yesterday very seriously on a letter which he addressed to me at my request on December 17, 1977 in which he affirmed that under no circumstances would he allow New York City to go into bankruptcy -- cut everything is what he said. The bottom line is if all else fails and further effort is required to balance the budget, then there will be layoffs, as difficult as that is for the individuals laid off. But the mayor who directs that to occur and for the people of this city they would suffer a reduction in services. The budget will be balanced.
Now we all recognize the very serious blow to the United States as well as to the world, without any question devastating to our city, as we face that eventuality; but I think it's important that this Committee have an idea as to how you, as principal executive of the state, feel about this question.

Suppose the Congress does not act. Where are we?

Gov. Carey. In my opinion, if the Congress does not act, we are right back where we were in 1975 and I don't know how this lassitude or seeming apathy has grown because the conditions are more grave in a sense now than they were in 1975 with regard to the federal dollar in markets around the world. The balance of payments is involved here. Certainly the credit markets in other parts of the country for municipal borrowings may have improved and that may not be true if there's any notion that New York is again approaching the brink.

With regard to the mayor's letter and what he would do to avoid bankruptcy, he has undertaken the stringencies which he speaks about in that letter. No mayor in this country nor any governor can create conditions or a climate in a financial market. We tried that and you know that our state as well as the city had no credit available to us in 1975 and through most of 1976 and we only reentered the markets when we secured the state budget.

We handled the billion dollars out of the state agencies that were based on moral obligation and assured those who provide
credit that our state and city budgets were in balance credibly and we had federal assistance as well. That's what it took to keep the state going and restore the state credit when it was impaired.

I invite you, Senator, to look at the Fordham Urban Law Journal in a very well written article on the limits of risk that were taken by the state. In some cases the court of appeals said we had gone too far and we had to seek alternatives because in the opinion of the court we had exceeded the amount of aid or assistance in some form that we could provide to the city. The moratorium is an example.

However, I want to return to the matter of the mayor's letter. I think what he's saying is that he will do all he can to avoid bankruptcy as the executive of the city, and I will do all I can to assist him as the executive of the state, but you recognize that we as a state have just gone through again our annual borrowing which is in excess of $3.6 billion that we borrowed for aid to the localities. We go into that market and we have had favorable reaction in that market because of the credibly balanced budget of the state. But let me quote a cite from the Comptroller that undue exposures of the state credit for further demand by the city or any other localities would jeopardize the state's credit and we couldn't help anybody. That's the size of it.

Senator Javits. Leaving out the word bankruptcy and the
commitments of the mayor on that score and yours, is it a fact that if the federal government does not act in time that we face a breakdown in the City of New York and what kind of breakdown would you conceive that to be?

Gov. Carey. Horrendous, because there's no question -- I'm sure the Comptroller, Mr. Goldin, painted the picture clearly here as he's done in the past -- that you do have peaks and valleys in the receipt of revenues in the city, but your payrolls come on a regular basis as do your other obligations for purchases of services and goods the city must have to continue its life, and you must pay your bills. If you don't meet your bills, then you're in default, default of payrolls or default of obligations and vouchers that must be paid to vendors.

Therefore, there has to be a steady cash flow to meet those obligations. That cash flow cannot be provided by the city with its own resources, with an inability to borrow, and the city has an inability to borrow; nor could the state supply a borrowing source on a short-term basis to the city to help just bridge it or help ward off any temporary insufficiency of cash because we tried that in November of 1977. We clearly earmarked state revenues in education that were due and payable to the city only 90 days henceforth and identified the revenues and attempted to enter the market with notes for the city through the MAC organization, and there was no market in December and we had to withdraw the offering. Nothing has changed since December. If we
tried it again in July -- I yield to Mr. Rohatyn -- but we'd
find the same picture and, therefore, if you asked me for an
alarm clock or for a time schedule, I'd say that you have to
set it for the summer of 1978 when the city would be in deep,
dire trouble and disaster would ensue without some form of
access to market through seasonal borrowing not of the city or
state's own resources.

Senator Javits. Mr. Rohatyn, would we have any access to
any source of money if the federal government doesn't act in
time?

Mr. Rohatyn. Senator, the mayor can write all the letters
in the world, but the city will be bankrupt -- period. It will
be bankrupt in August or September or some time and there's just
no alternative. I'm not saying that to scare anybody, but that's
a fact of life. It isn't the mayor's fault. The mayor can try
to balance all the budgets in the world, but if you don't have
access to markets you go bankrupt.

Senator Javits. The mayor had to say if the Comptroller
can't write a check the city will have to seek some form of
judicial protection. You would both agree with that, wouldn't
you?

Mr. Rohatyn. Yes.


Senator Javits. I don't believe, gentlemen, there's any
sense to gilding the lilly as to where New York City stands.
God knows, Senator Moynihan and I will move heaven and earth to avoid it, but if there's no substantive congressional action is the point I'm trying to make.

Secondly, Governor, I believe from all the evidence I have it would indicate that the city is in a very dangerous condition as to its physical plant. Bridges are deteriorating. Streets are in a condition of grave danger. Does the state have any facts and figures on that score?

Gov. Carey. We are engaged in a study with state resources from our State Department of Transportation to determine the most critical of all of them. As you say, they are in corrosive condition, but we are seeking to determine the most critical faults that may be determined in structures that carry huge burdens of heavy weight traffic around the city every day. Our freight, our personnel, our transit, all goes over bridges and concourses, many of which lack maintenance and are deeply in need of costly repairs. We in the state are doing our utmost to aid in that regard but without a capital budget, which the city has not had available to it, it's what no businessman would ever tolerate, and that is letting a plant run down so badly that frankly you will turn out your last product and find out you can't compete in the market. That's precisely what's happening. If we are going to make businesslike fiscal decisions, then the proper way to handle New York City's problem is to look at the free enterprise system and what you do when your plant is
out of date. You not only refinance so you can pay your workers and keep your plant going but you put a little aside in order to bring the plant up to date and allow it to operate functionally well for its citizens so they won't move out on you.

Senator Javits. Do you feel that the physical plant of New York is in dangerous condition?

Gov. Carey. My God, the whole Westway collapsed and fell down with a thunderous roar of concrete on police cars and almost wiped out patrolmen as they ride under them. That's what things happen. Too bad you can't hear the noise in Washington. It's the din and the thunder of a collapsing city because we're not keeping it up. The mayor is determined to do that.

Senator Javits. You say that the state is committed to using its resources to aid the city. Senator Heinz asked the question which was left unanswered. Could you wrap up in one answer the following two points: (1) New York State according to its constitution can't guarantee the city's debt. Why should the federal government? Second, you have already given the reason but I think it's essential here -- why in extremis should New York State not cut its tax relief in order to give the city whatever hundreds of millions it needs?

Gov. Carey. The answer is that any effort of that kind -- number one, the change of constitution. That was put before the voters once before. It was put before the voters in terms of picking up the entire welfare share of localities and applying
it to the state. The voters turned that down. The voters of New York are very sensitive and foresighted with regard to use of credit and providing credit to localities. That's why the constitutional impediment is there and I doubt if the voters who are listening to what has happened in California and are looking elsewhere and looking at the credit mount that was built in New York State would be very likely to give the state the ability to supply guarantees or credit to localities as they might call upon them.

With regard to the tax reduction program, we had to haul and shove and push, lumberjack and press as hard as we could to get the additional resources to the localities in this budget, to get the ratio to the localities as high as it is. We had a tax cut because we wanted to have that money in the localities to keep down the increases in local taxes, to stabilize the local tax picture, which is the highest in the country again. That's why we applied the tax reduction and the local aid program. The tax reduction was not at any time a matter of discretion. It was absolutely necessary, Senator -- you know and I know -- or more business would have left New York and more jobs and more unemployed would be there and we would be asking for more help and drawing down the unemployment benefits of the federal government and the welfare benefits. That's why we reduced taxes, to help the economy, and indeed, even if the state's voters agreed, the state could not supply direct
credit in addition to the $9 billion of MAC borrowed obligations bonding which is there. If someone would take a look at the state with its present extended credit, with the moral obligation now behind our state agencies like housing finance, dormitories, and the $9 billion of MAC, and see that the State of New York was embarking upon a guarantee program without the ability to have the access of the federal government to markets, the state credit would be jeopardized and no voters would approve it.

Senator Javits. So the worst thing you could do for the United States would be to break the credit of New York State by this route?

Gov. Carey. We went as far as we could in terms of prudence and discretion in that regard in 1975 and 1976 and right down to the wire we had to press very hard to be able to meet the obligation that we undertook to purchase $750 million of MAC bonds. That's what the state has done in the past.

Senator Javits. Thank you.

The Chairman. Senator Moynihan.

Senator Moynihan. Mr. Chairman, in a sense Senator Javits and I are witnesses before your committee, just as Governor Carey and Mr. Rohatyn and Mr. Kummerfeld, and I'd like to take on that role a moment to address some rather personal remarks to you which also at the same time are addressed to the people back home who might be watching these hearings and wondering about them.
The Chairman. Back in New York?

Senator Moynihan. Back in New York. I'm wondering about what seems to be the disproportion as between the issue before us and the atmosphere in which it's being considered, the atmosphere of foreboding and even distrust. We are talking about adding $2 billion in loan guarantees, not expenditures of any type -- $2 billion on top of a fiscal 1979 total of $298 billion the federal government guarantees on loans from everything from fishing boats to satellites, and yet there's an edge of exasperation in your voice and even disappointment but, Mr. Chairman, I think I know your secret. You have been giving out clues here and I think the most important so far is when you said to Governor Carey that Wisconsin and New York are the two most progressive states in the union.

I think you feel that New York has jeopardized that progressive tradition which matters as much to you as it does to us.

Yesterday you remarked that it was 1947 which was the first year that any bonded indebtedness was acquired by the City of Milwaukee and you said the socialist mayors there never borrowed a penny and I know why: because to maintain the reputation of progressive government you had to assure people that you were fiscally solvent and clearly in that sense we have let you down.

In the 1960s New York was all sail and no anchor. It was profoundly irresponsible to the point where it verged on
irrationality, and yet I would say to you that reality has been returning to us. In 1975 the agreement made in 1975 was only partially realistic. We continued to assume that there would be a great increase in federal funds to cities when there was no such increase.

Still, look at the people before you in these hearings. Look at what has been done. Look at Mayor Koch and his testimony yesterday. Look at Hugh Carey. He's the finest governor we've had in New York since Al Smith. He has got the toughest sense of reality. He's closest to the state and what it has to do to change. He has a very different job than Al Smith but it's the same order of effort and he's doing it.

What I'd like to say to you, sir, is that if you let us down now you will also jeopardize that progressive position. Wisconsin will have let New York down.

I think what you're proposing to do is to settle for a three or four year seasonal loan guarantee. I'd like to ask the Governor and Mr. Rohatyn, isn't it true that that just means that the present system of New York would be permanent? It would be a permanent part of the federal government. There would be no capital formation, no capital investment in the city because of the absence of long-term guarantees. Those loans will be permanent. Those seasonal loans will be permanent because every time they expire we'll be back here asking for them to be renewed and in the meantime the things that New York
and Wisconsin have stood for will have a generation of disrepute ahead of them and I don't know what would be left of that reputation when it's over, but I'd like to ask the Governor and Mr. Rohatyn -- the chairman is right in his concern -- but will seasonal loans not leave you permanently at this table?

Gov. Carey. It will not only leave us permanently at the table or recurrent in terms of our address to this committee and our reports to the committee, but it will definitely keep us on an umbilical cord directly tied to the federal government and that's how we'll be fed the credit we need on a month-to-month or quarter-to-quarter basis. That's what we have been going through.

I strongly agree with the chairman's attitude and philosophy which he expressed as I read it in the papers today, that you don't want New York as a dependent coming back, and that's what seasonal does to us because I have had to certify for the Control Board and for the city our request for seasonal credit assistance and in each case we have had to have observers there. We have welcomed Elinor Bachrach on this committee who has been watching us keenly as we deliberate, but we have had to make our address formally to Secretary --

The Chairman. I'm sure that watching goes both ways in this case.

Gov. Carey. That's part of our progressive tradition.

So we have to continually respond to our mentors and masters
in the federal government as long as we are on the seasonal umbilical cord; whereas if we are out there navigating in the credit markets with a guaranteed proposal we've put in place -- the Control Board, which is stringent in every regard -- and we have the MAC monitoring as well, the MAC Board acts as a monitor for its investments, and with a guarantee proposal in there and investments secured and seasonal reducing, we would be here less frequently and perhaps -- not perhaps -- with the guaranteed program in place and the leadership of Mayor Koch carrying on the directions of reforms that he has enumerated, we would not be back here. We can say that. We would not be here totally dependent on a hand-to-mouth basis, as I said, making quarterly reports of the very kind that are made by someone who gets on an installment plan basis and has to keep going back to the factors to pay his bills. We want to get out of the factoring business and show our creditworthiness on a long-term basis.

Mr. Rohatyn. Senator, I'd like to make a somewhat different point. Three years ago the city's economy was about to go down the tube. Right now there seems to be the beginning of a turn in the city's economy. The security through federal credits or anybody's credits, whether the city can go back to the market, needs the city's economic recovery because that's basically the issue.

In my judgment, the city's economy might continue to recover and flourish and increase its tax base and therefore
increase the city's creditworthiness if there is some obvious lengthy period of stability ahead of us and that stability, in my judgment, is best assured by guarantees.

Now I think, again, we keep getting hung up on semantics here. A seasonal loan that runs three to six years, that's a hell of a season; Senator, and we shouldn't kid ourselves into thinking this is really short term financing. It's called short term financing but because of the fact that it is the wrong kind of financing it will have to keep getting extended and it will turn into long-term financing with the wrong kind of long-term financing. So we and you will have all the worst effects of short-term financing. You will have long-term financing facing us. We won't get any of the benefits and we will both be the poorer for it. It just seems to me that that's wrong.

Senator Moynihan. Mr. Chairman, give us a chance. We won't let you down. We know what you're trying to protect and you're right. We know something of value is at stake. What is at stake is the reputation of progressive politics in America, but we know that, sir. Give us a chance. Thank you.

The Chairman. Well, thank you, Senator Moynihan. There's no question in my mind that the committee will give New York a chance and, as you know, in 1975 this committee came out and supported the position that had been opposed by the President and we succeeded in getting it through the Senate and it went
through the House and we provided the seasonal loans we provided. But I think we have an absolute duty to challenge the presentation here in detail and I do think that there's lots of evidence that the several groups in New York that could do better are not doing it. Now maybe I'm wrong, and one of the purposes of this hearing is to find out whether I am or not.

Senator Moynihan. If the chairman won't mind my saying it, the mayor publicly thanked you for what you had done and he meant it and he was right.

The Chairman. I appreciate that and, of course, that leads into one of the other points. The colloquy in the last few minutes has been based on the tempting notion that if we follow the policy proposed by the Administration that has passed the House we won't have to worry about this. I think that's a wrong kind of attitude that we should take. I think we should be deeply involved, deeply worried, on top of it all the time. We should require an accounting constantly and the only way you can do that is to have a termination. I think if we have a guarantee that goes out until almost the year 2000 we won't have that kind of insistence on performance and success in achieving performance that we have had in the last three years.

Everybody has testified and we all know there's been great success in the last three years. You have made real progress. You deserve a lot of credit for that. As long as the federal government is involved I think the Congress ought to take a
look at this just as much as we can, and I think we are much more likely to do that if we have the kind of device that Arthur Burns suggested and Bill Stanton suggested, although I frankly think you can do it without having a guarantee that goes out for a longer time.

Senator Javits. Would the chair yield to me for a moment?

The Chairman. Certainly.

Senator Javits. Pat said one thing which was correct. We are witnesses as well as Senators as well as questioners. I would like to add one point if I may, Senator, as a witness.

I think you have all emphasized the negative. Pat has raised one positive which is the progressive philosophy which I think New York exemplifies. But also, the other aspect, Mr. Chairman, if I may, to you, is the national interest of the United States, the positive national interest of the United States. To recreate New York would take hundreds of billions of dollars. You can't replace it in less than 100 years.

The Chairman. Senator Javits, nobody disagrees with that.

Senator Javits. But this city is collapsing, Mr. Chairman.

The Chairman. That's where we disagree. I'm not so sure that's the case. In fact, I feel very strongly that New York can do the job if it has to do it. It won't be easy. It will be a lot tougher for the banks and the labor unions and the pension funds and the mayor and the governor and the state legislature, but I think they have the resources there. If they
have to do it I think they will do it and in my view what Mayor Koch said to us yesterday is of the greatest importance. He said, as he indicated in that letter to you, that bankruptcy isn't part of his vocabulary; he will do everything he can and he will do a whale of a lot. I disagree that the mayor can't prevent bankruptcy. Of course he can. It's tough and some of the cuts might be extraordinarily difficult, but whether or not they would be counterproductive is a matter of judgment. A whale of a lot of people in New York City don't think so. My mail is running three to one, three-quarters of the people who write me from the city say, "Don't continue federal assistance." They want pressure on the officials to hold down spending and that's what the mayor said he would do. He would take the lower priorities and cut those first and continue to cut until he was at a point where the budget was balanced. I realize that's not a complete answer, but I think that's a beginning of an answer and I think the banks would come in under those circumstances if they had to do it with their enormous resources, with what I think would be the minimum risk, if they put their own monitor in place so that they wouldn't really be taking a great chance.

Senator Javits. If I may just finish my thought, the question is, is it worth the risk? And what Felix Rohatyn and the Governor are pointing out is that it isn't. What Pat has pointed out, when you compare what's involved here to the
aggregate amounts which are involved for the federal Treasury every year, which is 10 and 20 times what we're talking about in either seasonal loans or in guarantees, it isn't worth the risk.

The Chairman. Well, you may well be right, and that's the judgment the Committee and the Senate will have to make.

Gov. Carey. Mr. Chairman, I'd be less than candid -- in fact remiss in my duty as Governor not to refute the notion that any mayor -- the mayor of Yonkers or the mayor of Buffalo or the mayor of New York City -- could take such austere budgetary measures over the short term to balance his budget and to avert bankruptcy if he lacks access to credit. He simply cannot create a market himself even with a balanced budget, which he might be able to achieve with some miracle of magic, but he would not have access to the market.

The Chairman. I will agree, if you make the assumption that the pension funds are going to say, "No way. We'll take bankruptcy;" if you say the banks will say,"No way. We'll take bankruptcy." I don't think they will say that. I think they have too much at stake, both those institutions, and they both have the resources that can take care of this situation.

Gov. Carey. Again, it's a question of speculating on the risk, and I say that risk was before us in 1975 and we averted that and it's helped a great deal in giving the spirit of hope and optimism, and maybe that's why you're getting mail, even at
the 15¢ postal rate, but there are a lot of people who can't afford to write and they hope and expect that there is going to be some kind of federal assistance, only on the credit side -- not submissions which would be for some additional support for housing and jobs in our city. We await that and we are not here asking for that kind of help. We are working our level best to help assure that kind of resource to all. New York has made a major contribution to other parts of our country. We hope to be able to continue to make that. It's a heavy tax burdened state. We couldn't cut our federal taxes this year. We did our best on the state level, but we do -- there is a consideration of a possible federal tax cut and that would be very helpful to New York where our economy is so depressed that frankly we don't have wage earners to pay taxes. That's the condition we're hoping to cure. That's why the capital improvement program is so important, because the laborers -- there are 30 percent and up in terms of unemployment. That's gone on for years. We can't abide it.

The Chairman. Let me ask Mr. Rohatyn. You say you have not yet had any firm commitments from the banks or the pension funds to finance New York City.

Mr. Rohatyn. That's correct.

The Chairman. Any additional federal aid would have to be contingent on a firm commitment from local parties, the pension funds and the banks, to provide the rest of the financing over
the next four years. As the Governor and you have pointed out, the federal part of this package is relatively modest. The principal assistance would come elsewhere and if these parties don't keep their commitments then the city might well default on the guarantees. Unfortunately, we have before us now firm evidence that at least one of these parties, the pension funds, can't be relied upon to comply with a binding legal commitment. In the past few weeks the pension funds have refused to make a $703 million investment in city bonds that they agreed to make back in 1975, even though this meant pushing the city into a cash crisis and ironically delaying a city contribution to the pension funds.

How can we provide long-term federal guarantees when we have seen that the pension funds are not willing even to meet their existing legal obligations? They made a promise. They are not keeping it.

Mr. Rohatyn. First of all, Senator, we expect those pension systems to keep their commitment, their commitment technically speaking. The contract we have with the pension systems is for an investment any time on or before June 30. We have told them, as I told you earlier, that we took that to be a legal commitment and we will go to court if they don't keep it.

Now in the same breath I have to tell you that we will go to court and it won't make them put up their money if they don't want to do it. We expect them to do it.
The Chairman. They still will?

Mr. Rohatyn. They did buy $350 million worth of MAC notes.

The Chairman. Let me follow up the relevance of this.

If we got down to 1982 and the guarantee authority were expiring, couldn't you just run into the same situation again; the pension funds refusing to do their part unless we gave still more guarantees?

Mr. Rohatyn. Senator, first of all, I think whether there is a seasonal loan extension or a guarantee program, either one of those will require commitments for long-term funding built around it and either one of these will inevitably require commitments by the pension systems over whatever period we use here. I don't expect any more in the case of seasonal financing as in the case of guarantees that any following year takedown or any following year commitment will not be conditioned on all of the parties making their commitments at the same time and if those commitments aren't met, then this would be an event of default.

If I may challenge one thing you said, Senator -- or one thing now, there is the notion that we can't build the same kind of protections and disciplines in long-term financing as we can in seasonal financing. You can build events of default into a long-term mortgage.

The Chairman. You can if you have a guarantee that only goes for a year or two or three. If you have a guarantee that
goes out 15 years it's much more difficult.

Mr. Rohatyn. You can have benchmarks that have to be met every year.

The Chairman. You can have benchmarks, but you have to have those benchmarks enforced and somehow, in my view, it's easier for the Congress to take a decisive step than the Secretary of the Treasury under present circumstances anyway.

Mr. Rohatyn. It would seem if any event of default is not met on an annual basis -- and that would obviously include meeting of the financial plan --

The Chairman. You see, the fundamental problem is once the guarantees are out, then the government is at risk for a billion dollars or for more than a billion dollars and we have to protect our money, so we protect our money by providing more assistance.

Mr. Rohatyn. Senator, the government is as much at risk with a seasonal loan -- a seasonal loan has the same security if there were event of default; you could foreclose whether you have a seasonal loan or whether you have a long-term loan.

The Chairman. Seasonal loans are paid back at the end of each year.

Mr. Rohatyn. But they are secured by the federal revenue sharing, Senator, and so would the guarantees be. You would have ample security.

The Chairman. That security, as we pointed out yesterday, is a very weak security.
Mr. Rohatyn. I didn't point that out, Senator.

The Chairman. If the city were in that kind of shape that
would have to be in issue. There's no way the federal government
is going to say we are going to cut off your revenue sharing at
this point or anything else.

Mr. Rohatyn. That's true with seasonal loans.

The Chairman. You say the banks might lend $500 million to
the city if conditions they have attached are met. Do you
really think that $500 million is a reasonable commitment for
the clearinghouse banks to make, $500 million over the next
four years for 11 institutions with combined assets of over
$281 billion? We calculated if they do just the $500 million,
then their proportional investment in New York City related
obligations would drop by over 40 percent in that period, down
to one-half of one percent of assets. Now why shouldn't the
bank commitments be higher? We calculate that they could put up
$2.5 billion, all 11 of them, simply by returning to the 1975
level commitment of .92 percent of assets. Is that too much to
ask of the New York City banks, that they devote something close
to one percent of assets to financing the city they live in?
Why haven't you obtained a larger commitment from the banks?
After all, they have made money hand over fist over the years
out of this investment.

Mr. Rohatyn. Senator, I agree with you completely. We
would love to get $2 billion from the banks and $2 billion from
the pension systems and go home. I think that would be terrific. It is just not my money.

Now we have asked -- Senator, first of all, we are requesting a billion from the banks, half seasonal and half long-term, as I said earlier, and I expect them to be at risk on both. That amount of money would maintain their percentage in terms of the city and MAC percentage to what has been the average in the last three or four years. They have turned us down. They turned the Secretary of the Treasury down when he asked them to put up $800 million. As I said, we are asking them for a billion, half long and half short, and we just do the best we can, Senator.

What we are trying to put together is a plan that seems to be able to work and where I can tell you I think we have a reasonable chance of putting it together. I can't -- as I said earlier, I would be happy with $2 billion from the banks. I would be ecstatic.

The Chairman. If you look at other states and the major cities in our states when they get in trouble because they need credit, they would sit down with their bankers and the bankers would find a way. They recognize a responsibility to their city and they take pride in it. Here's a city that has six of the ten largest banks in the country. It's very, very hard for us to accept the notion that they say let the federal government do it.
Mr. Rohatyn. I'm not here to defend the banks.

The Chairman. They will be in. But you have great knowledge of the banks.

Mr. Rohatyn. Certainly. I also have a great deal of respect for a billion dollars. I think that's a lot of money.

The Chairman. You deal with the banks all the time. You know the tremendous assets and capital they have. You know the risky loans they make to Zaire and Peru and other less developed countries. You know they live in New York City and they draw much of their reputation from being based in New York City, the financial capital of the world. They know the progress the city has made in the last three years, and the security of their investments in MAC bonds, and the additional security for city bonds that they have negotiated with the state legislature in recent weeks, and finally, they know they need to get back in the business of underwriting and marketing New York City obligations because it's an immense business and immensely profitable. Why shouldn't the banks be willing to commit themselves to meeting a far larger share of the city's financing needs, especially long-term, until it gets back on its feet and back in the markets on its own?

Mr. Rohatyn. Senator, again, all I can tell you is I think that I would be delighted if the banks put up more money. I would be delighted if the unions put up more money. I'm sure one could make the same argument that you just made with respect
to the bank loans in Zaire to the effect that the U.S. Government
is rushing over to Zaire to rebuild its economy because somebody
blundered.

The fact of the matter is that I was not successful in
obtaining a larger commitment. The Secretary of the Treasury
so far has been unsuccessful in obtaining a larger commitment.
I neither condone or condemn this. I'm again trying to build
a financial structure that we can all walk upon at minimum risk
hopefully both to the city and the federal government.

The Chairman. Have you discussed with the banks whether
some kind of additional sort of monitoring or some kind of a
change in the security they have...would induce them to make a
larger investment?

Mr. Rohatyn. Senator, the Control Board legislation --

The Chairman. I realize that's a very good step. I'm just
wondering why don't you go farther if that would do any good?

Mr. Rohatyn. I don't believe that, Senator. If you ask
for my judgment, I think it will be a push to get the billion
dollars of long and seasonal that we're talking about from the
banks, rightly or wrongly, and again I pass no judgment on it.
We are negotiating with the banks and I think the Governor's
staff was negotiating still with respect to certain aspects of
the Control Board legislation. Bear in mind that the Control
Board, Senator, is tied to the life of any MAC bonds issued here-
under and not necessarily to the length of the guarantee. So
the state, in effect, will be involved in this operation and we expect to issue 20 to 25 year bonds, maybe 30 year bonds, but the answer to your direct question is my judgment is, no, they would not increase their participation upon some change in the Control Board legislation.

The Chairman. My time is up.

Gov. Carey. May I say, Senator, that we are moving to put in place a study of the market access and how we define it and estimate whether or not it's there for the city, and our whole objective -- banks, unions, pension funds, city fathers and all -- are to get the market access at the earliest possible time and that's the piece of the legislation which the banks are looking for as some additional security that they won't be left holding the paper they have, that they will have paper that will be transferable because the city will be creating a market. That's a technical point we are still haggling over. We are pretty much in agreement now on how we can do that and our staffs are working on it to finish that last piece of the EFCE. That's the reference I made to the final matters that must be addressed by our state legislature.

The Chairman. Senator Heinz.

Senator Heinz. Thank you, Mr. Chairman.

Governor Carey, you were indicating I believe that the city's -- maybe it was Mr. Rohatyn -- the city's economy is an essential determining factor as to whether the city makes it
over the long haul and whether we're going to see a New York
that everybody can look to with the pride that we have in the
past.

Governor Carey. I would say the regional economy, Senator.
New York is an important center and New York is a regional
center.

Senator Heinz. I believe you went on to say the only way
we can assure the economic growth of New York City and thereby
the region is through these federal guarantees.

Gov. Carey. I'd say it's a major assistance in giving a
sense of security that anybody locating in that city or now
located in the city is not going to come up against a bankruptcy
condition and those matters are ground into the analysis that
businessmen do as they make their plans four, five and ten years
down range about where they want to headquarter and where they
want to settle people.

Senator Heinz. We can all see long-term guarantees can
have some benefit to the city. At the same time, it's generally
accepted that the reason the city is where it is today is
because, as Senator Moynihan characterized it a moment ago, there
were totally irresponsible, even totally -- I forget the exact
word --

Senator Moynihan. Irrational.

Senator Heinz. Irrational acts taken in the '60s and so
forth, where there was no regard for cost. There was no real
resistance to some of the settlements that were made to some of the unions. There was no real attempt at tough management. Now granted that's changed quite a bit today.

Gov. Carey. Senator, I think Ponce de Leon and Houdini were running up and down the Hudson River between Albany and New York City during that period. The defies how it was when the state had a zero growth rate and we were losing 900 private sector jobs how there were some 400,000 public employees added to the payroll and all the fringe benefits that set records.

Senator Heinz. We understand each other on that. If a guarantee is made, if an underwriting in effect is accomplished, don't you think there will be a lessening of the pressure on New York City to keep its house in order? Remember -- and Mayor Koch may be doing a good job today, but we don't know whether he will be in two years as successful and some people would even argue that where he came out in his labor negotiations was unsuccessful given his goal of a $600 million total settlement as he was -- we don't know where he will come out two years from now and four years from now when the sunset provision and the new legislation goes into effect and arbitration is no longer subject to a court review as it is as I understand for the first four years. We really don't know what's going to happen four years hence.

As you well know, in Nassau County some of the uniformed employees went to arbitration and got a contract of an increase
of 26 percent, if my memory serves me correctly. So we don't know what will happen.

Gov. Carey. That's a poor example to cite, if you will, Senator, because that arbitration was arranged by what we call a local public employees relations board under county control. The arbitrator was not picked from the state panel. That is not a closed chapter on how that arbitration got the 26 percent. That's a budget buster that's forcing taxes on the people of Nassau, taxes that are, believe me, unendurable. They didn't have the Control Board there.

Senator Heinz. I wouldn't ever disagree with you about anything you say about how taxes are unendurable, particularly in this election year.

Gov. Carey. You see, you're citing something and there's a tax revolt on in Nassau County right now and there will be --

Senator Heinz. And there should be. I understand that.

Gov. Carey. That's the kind of pressure that's going to be generated whether or not there is a federal monitor or a state monitor.

Senator Heinz. The point is that arbitration is an unknown factor, Governor. That's all we're trying to say.

Gov. Carey. Senator, I proposed to the state legislature in my State of the State Message that there be a redress from any arbitration aware to a higher governing level -- in other words, a legislative panel, if there was an arbitration award in
excess of the ability of the budget of the locality to pay. I couldn't get it from the state legislature. I got a court review instead, but we haven't given up and I think the taxpayers are going to demand it.

Senator Heinz. But my question is: with the guarantee, I might not be able to keep a relatively tight leash on the city of New York. We might not be able to keep a tight leash on the City of New York.

Gov. Carey. As long as the guarantee lives, the sun does not set.

Senator Heinz. Well, but the real question is: how can we keep the City under the kind of pressure which Mayor Koch, Carol Bellamy, and the rest of the people who were before us yesterday indicated was very helpful to New York in getting its house in order? How can we help them to help themselves if we don't find some way, as Senator Proxmire suggested, to review and see that the progress is constantly being made?

Gov. Carey. We have no reservations about constant and intensive review. That's why the generally accepted accounting systems are in the city now. You can get facts and figures you couldn't get in 1975. The state couldn't get the facts and figures in 1975. The place is more orderly now than any institution of any kind, public or private, in the world. It's Macy's window 24 hours a day with all that's going on in finance and anything that's there can be seen. The total viscera of
the city is financially exposed all the time. That's the condition people are going to insist on maintaining even if Congress didn't insist on it. They are mindfully aware of the past.

Senator Heinz. Suppose something goes wrong. Suppose in spite of all this transparency, in spite of all this openness, the city gets not into better financial shape but worse. Then where are we?

Mr. Rohatyn. Senator, let me say something here. First of all, there are going to be a lot of long-term lenders in this picture who are going to be in for bigger amounts and longer periods of time than the federal government. They are all going to require covenants. They are going to require events of defaults. They are going to require annual submissions and if those submissions are correct, they will trigger events of default. The federal government will have security. We'll let the lawyers for the Metropolitan Life Insurance Company -- and believe me, there isn't anything that goes beyond that that I know of -- write your covenants for you on the guarantees and every year you will have an event of default and you can trigger this whole thing and I would hope to be able to satisfy Senator Proxmire on that issue.

I am very sympathetic to the issue of security, to the issue of discipline, to the issue of making sure that your loan is as secure, if not more so, than it is today. I am not arguing against that at all. I am trying to purely intellectually
and dispassionately tell you what seems to me to be the most appropriate financial structure to get us all out of this thing. From the point of view of security, I'm absolutely convinced we can satisfy you, not with just showing viscera, what everybody can see.

Senator Heinz. The point I raised was not security in terms of coverage of the debt service.

Mr. Rohatyn. When you have an event of default that comes up and begins to accelerate all your other debt, that really focuses people’s minds on the fact they have to cut their budget.

Senator Heinz. Yes, it does, but I think we understand that the very fact that the seasonal loan package has expired has forced the State of New York and the City of New York and everybody to try and be much more realistic and do a much better job.

Well, my time has expired but I thank you for your comments.

The Chairman. Senator Moynihan.

Senator Moynihan. Would Senator Heinz like me to yield time to him?

Senator Heinz. No. I'm satisfied with the amount of time.

Senator Moynihan. Mr. Chairman, I haven't any large final thoughts save one. I don't know how large it is, but the fact of this question of a bank monitor you raised -- there's really a question of representative government at stake here. The
Congress should be more concerned about representative government than just about anything else. As a matter of fact, the constitution guarantees the states a republican form of government. I wonder if there isn't some residual concern about the cities.

I remember -- Governor Carey will know this, but I think it was in 1856 somebody introduced a bill in the New York State Legislature proposing that the government of the State of New York be turned over to the board of directors of the New York Central Railroad and it was meant as an irony but the bill passed the assembly and -- well, that was the spirit of the 1850s. I cannot imagine in 1978 we are going to turn the city of New York over to the banks.

Now we have a real problem in the city. It is prepared to accept an Emergency Financial Control Board which in fundamental ways suspends self-government in New York City for the next generation -- the next generation. I mean that city has governed itself since 1624 with brief interruption under General Howe. It has run its own affairs. Now we are prepared to turn them over to a control board almost running into the 21st century, but at the very least it will be a control board appointed pursuant to law with the representatives elected by the people of the State of New York on it -- appointed by the Governor, appointed by the Mayor.

Can we seriously, as a Congress of a democracy, propose
that it would be a better arrangement if we let the banks run it? There's a matter of proportion here. What will representative government looked to have become if we do this? I wonder if the governor wouldn't just comment on that.

The Emergency Financial Control Board is an unprecedented arrangement but at least it derives through law and elected officials and not simply the power of money.

Gov. Carey. Senator, we have a Control Board in Yonkers and one in New York City. It does not govern either locality. Let's make that clear. It does keep it fiscally responsible and it stays as far away from policy considerations as we possibly can, but let me recite the history of 1975 and tell you that a Control Board, as you point out, pursuant to a law, appointed by publicly elected officials and controlled thereby and with representation on the Board of the private sector, is a working condition that does preserve self-government to the ultimate degree possible for that city or for any other locality.

A different condition obtained -- I want it on the record here -- the condition obtained when the State of New York was at the mercy of the banks in February of 1975 when the largest public agency in the country, the Urban Development Corporation, faced a technical default because it couldn't meet a bond payment that had been issued one year prior to my taking office. It would be interesting, if somebody wants to pursue it, to read
the Shell Commission on the utilization of the moral obligation borrowing and the Shell Commission went into this whole question as to how we got into the condition of having the state teeter on the edge of default because of our obligations to the banks and other lenders.

Let me say at that time we were far more the servant and under the control and subject to the will of the banks than New York City had ever been. We had to work it out. I had to go to the state legislature and get the moral makeup money. We had to do extraordinary things to rescue that state agency and other state agencies. There was no Control Board. The banks called the terms.

When we tried to put through the Project Finance Agency in order to finance the UDC which turned out to be very successful, the banks lobbied for and against depending upon what they wanted in that legislation, and sometimes they got their way and everybody saw them up and down the corridors calling the shots on the line.

If you want the banks to really take over and run the City of New York, then say so. But you won't have many people living there and I don't think the banks want the job. I wouldn't want it if I were a private investor. We have tried to prevent that. We have tried to preserve to the utmost degree possible the control of the City of New York to the people who live there and elect their officials. That's what we propose here. It's the
finest exercise of representative government I can think of to have me, as a Governor, come before you as our Congress, as the Senate, and make a plea to preserve what's left of self-government so we can see a better day for New York City and New York State, but don't put us back in the bondage of the banks in which I was when I took office in 1975 with a state agency losing $30 million a day and a billion dollars of outstanding borrowings with no revenue to support those borrowings. That's only part of the story, but we lived from January until June under that condition and I know the banks very well and I know now why they were a little bit shy on taking on more of the obligations given that experience that came to a climax in 1975. The Shell Commission is interesting reading for this Committee and I have never indulged in recriminations as to why that condition occurred or how we got there, but we don't want to get back into that condition of being totally subservient and reliant on the banks.

Senator Moynihan. May I just say in closing the conditions Governor Carey referred to was not of his making. It's he who has unmade those conditions. He's brought the State of New York back to solvency. He's bringing the City of New York back. Senator Javits had to be at a luncheon where he's host to Mr. Witteveen of the IMF, but I know he's with me when I say you have heard the quality of our Governor and what he has done and what he commits himself to do, and I just ask you,
Mr. Chairman, to give us a chance, give New York City a chance. Thank you.

The Chairman. New York City is certainly going to have a chance.

Let me ask you this, Governor Carey. I know that legislation to increase MAC's borrowing authority and to extend the Emergency Financial Control Board was finally passed by the state legislature and you signed it into law last week. However, I am disturbed that the effectiveness of this legislation was made contingent on the enactment of federal guarantee legislation. This Committee has made no commitment to approve federal guarantees; quite the contrary, and when we called for passage of such legislation by the state in our February report we made it clear that we thought such legislation was essential for the city to be able to meet its financing needs after June 30, 1978 with or without more financial aid from the federal government.

Now what effect does this development have on the city's financing plan? How can you line up financing commitments based on legislation that may self-destruct if the federal government doesn't come through with guarantees?

Gov. Carey. This point was well debated and considered by the legislative leadership and by the membership of that legislature and the whole motivation for making the Control Board as stringent as we could was that we would come with clean hands, indeed showing our stains of labor, to this Committee and
say that we put everything into that legislation that we possibly could, over bitter resistance by many who didn't want that Control Board strengthened, didn't want to lose again any more of the self-government, home rule of the city. We did it predicated upon the fact that this was what the Congress, your Committee, would require of us in order to satisfy the conditions that would qualify us for federal guarantees.

The Chairman. Of course there's understandable -- I don't know whether you'd call it resentment -- but reluctance to act when you put your conditions on it and say in effect it's got to be a guarantee or these other commitments won't follow.

Gov. Carey. Let's say it made it much more feasible for the legislators to vote for it contingent upon the fact if we do all in our power to do our share that we will expect your share.

The Chairman. Supposing we pass the seasonal loan instead?

Gov. Carey. We're not going to turn it down.

The Chairman. Then you have to go back to the legislature and perhaps the legislature won't act. We'd have to do it with a stab in the dark hoping they would act.

Gov. Carey. I know enough about the legislature that in an hour of dire need they will not force the city into bankruptcy. It will be difficult to do but our history in New York is that we do the difficult.

The Chairman. Well, the life of the Control Board is tied
to the length of the guarantees even if these are enacted they could be much shorter term guarantees than presently contemplated. There's no way of knowing at the present time. That means the life of the Control Board could be as short as six years, three years after the city is supposed to achieve a balanced budget according to the sunset provisions in the act. I understand that does concern the banks. It's not a matter of the banks wanting to run the city. It's a matter of them wanting the protection of your Board.

Will you have problems getting financial commitments from the banks with legislation in this form?

Gov. Carey. We are trying to work that out. After a very extensive negotiation I believe the sunset factor with the market access question is capable of being resolved. We are working under that. And the question of how we determine what market access is is a key one. The determination that the city has market access for one year and will continue to have access for the coming year is the key consideration and we are looking to some umpire, some arbitrator, who can make that determination, someone like Comptroller Levitt, somebody of his stature, who can supply to any fair-minded person the judgment that market access is there. The banks are worried about the unions withholding securities from market and the unions are worried about the banks that might withhold access to hold on to their securities in some fashion. Everybody is worried about everybody
else. That's why it's difficult to work out the language. But despite the difficulty, we are at the point where I believe the sunset provision and the consideration for market access is at the language stage and I feel it will be in place and should be in place well before the deliberation of this Committee come to a conclusion.

The Chairman. Mr. Rohatyn, do you see this as an obstacle, getting commitment from the banks?

Mr. Rohatyn. The Control Board language, sir?

The Chairman. Yes.

Mr. Rohatyn. No, I don't, Senator. I do think that the issue of what kind of commitments, if any, we can get in case of a seasonal loan extension as opposed to a long-term guarantee is an issue on which I can give you no assurance. Obviously the legislation from MAC would have to be abandoned, that goes without saying, but whether we can actually put a workable financing plan together -- because we would need $2.5 or $3 billion or whatever, depending on the length of time that the seasonal loan is extended, most of which I would guess would have to be made up of a private placement because I think the MAC market would be in some considerable difficulty -- we would obviously try our best, but I must tell you that it will be very, very difficult and whatever package comes out of it a rather unsatisfactory one.

The Chairman. Governor Carey, earlier today toward the
initial part of your -- I guess in your opening statement, you indicated that the negotiated labor contract you felt was a fair one, however that may not be the question because it is a very costly one. The city would have to pay $750 million over the next two years as a total price tag of $1.1 billion. It is substantially bigger than the mayor indicated he wanted. He was disappointed that he couldn't hold it down. He got no give-backs and so on.

Now the question is: you're chairman of the Emergency Financial Control Board which has to act on that contract. In your judgment, can the city afford a pay raise of that size? Will the Control Board approve the contract?

Gov. Carey. It will not be my judgment that will prevail. The Board will be convened to consider the agreement.

The Chairman. Well, you're chairman of the Board and you have a vote.

Gov. Carey. As chairman of the Board, I was there during the negotiations for many hours when those negotiations were in deliberation and it is my opinion now at this time that the financial plan of the city will accommodate the settlement.

The Chairman. Now you and the mayor recently announced that the city will go ahead and build a huge new convention center. It's been under discussion for some years. I've got strong doubts about the need for the city to make that expenditure. It's supposed to cost $257 million, a great deal of money
for a city in New York's financial condition, and there are likely to be big cost overruns. Furthermore, the city will be incurring responsibility for at least $10 million a year more in debt service down the line, plus an operating deficit which is likely to run higher than the $1.9 million presently predicted.

Why should the city put all this money it doesn't really have into a convention center that may turn out to be a white elephant? Wouldn't it be better to save the money, or at least spend it for a better purpose?

Gov. Carey. There's no city capital commitment involved whatsoever.

The Chairman. I understand that, but you have the debt service obligation.

Gov. Carey. As far as the debt service is concerned, it would be a joint venture or partnership. It's sad to relate that Niagara Falls has a convention center built under the Urban Development Corporation and New York City does not. It's just getting New York City up to the level of the convention attraction that we have in Niagara Falls.

The Chairman. You have Madison Square Gardens and you have all kinds of facilities in New York City.

Gov. Carey. None of sufficient size to attract the kind of convention business we need. Because we recognize the economy of New York is essentially going to be for the time foreseeable a service oriented economy that will serve tourism, that will
provide cultural attractions and by every estimate -- the Port Authority of the State of New York and New Jersey made a study and recommended the construction of a convention center -- numerous persons -- we have an Economic Development Board comprised of private sector persons, economists and analysts who recommend that we have such a central attraction to draw tourism and draw conventions and expositions to New York.

The Chairman. But it does sound like "business as usual." I could understand it if the city were in good shape and not relying on the government, but in a time when you're strained and stressed and doing everything you can to hold down your spending to engage in this kind of additional expenditure when, as I say, there are convention centers all around the country, many of them not doing business, many of them obviously mistakes -- this wouldn't be finished for some years and then it would be a burden forever. Nobody expects it to make money. It will be a loss of $1.9 million a year.

Gov. Carey. You're a good enough economist, Senator, and I know you agree with me on this -- or I hope you will -- that we take the debt service cost which we recognize will throw off as annual deficit, but we take in from what we expect to receive from the increase in tourism generated from that and they will be paying taxes -- we have an occupancy tax and tax on purchases of commodities and sales tax and various excise taxes that exist in the city, and they will be paying fares in the transit
system to get around, and we know the return to the city and
state will more than offset the cost of debt service or any
deficit because we have analyzed this -- and not for just one
year or two, but this has been under analysis for more than ten
years and the lack of that center in New York City has cost us
a fortune in terms of booking conventions because conventions
are booked five and ten years hence.

The Chairman. As you know, there's the other difficult
factor. This is a decision that's going to be made by the
Senate. Many members of the Senate --

Gov. Carey. It's not a burden on the city.

The Chairman. There are so many members of the Senate --
you take business away from Atlanta or away from Chicago or
Milwaukee and you take it to New York. You're not going to have
any more convention business in the country because of what
you're doing.

Gov. Carey. I guarantee that New York will never take
convention business away from Milwaukee, not while you're the
beer capital. Really the convention center is meant to be a
functioning place, not a white elephant, because we're planning
it so we can build into it some features that will give us
day-to-day utilization or week-to-week utilization. We need
sound staging because more and more motion pictures and docu-
mentaries and TV specials are being shot in the New York metro-
politan area. We can build some of that in there and get
utilization of the structure for other purposes than the con-
vention business.

All of the things you spoke about by the way -- the Madison
Square Gardens -- many of those are much smaller in size than
similar structures in much smaller cities, yet they are filled
to capacity and provide revenues to the people in the city.

The Chairman. Let me ask you about something that really
troubled me very much because it's another indication of the
state not doing what it seems it could do.

The city's original financing plan called for 90 percent
federal guarantees with 10 percent state coinsurance. That was
one somewhat appealing feature in an otherwise unappealing plan,
since I believe strongly that the state should do more to meet
the city's financing needs.

But that 10 percent coinsurance seems to have disappeared
from all the succeeding financing proposals. It's not in the
House bill or the Administration bill. What happened to it? If
we were to consider a financial aid bill, either long-term or
short-term, should we include state coinsurance or some other
type of state financing?

Gov. Carey. If we had to put that money in the reserve
in the first instance and put it aside, the money would not be
there to help close the gap in the city's budget. So we put it
up in cash and we increased our commitment to the city up to
$250 and nearly $300 million of aid in a budgetary fashion. So
we put the money there so, in effect, the guarantee wouldn't be needed. We put the money in the state budget. If you take the money back from the city we'll open a hole in the city budget and that would create a fund that would be the 10 percent coinsurance you're speaking of. That 10 percent coinsurance feature would present a problem because it's to be coextensive with the term of the guarantee and then we may run into a legal snag, a constitutional impediment, because we couldn't assure you that a future legislature or future governor will insure the first instance operation and will put the money up on an annualized or periodic basis.

The Chairman. It runs into your constitutional prohibition?

Gov. Carey. It may. We would have to set up a reserve and if the reserve became depleted do the moral makeup.

The Chairman. We had asked you to amend your constitution in our report in 1976 and you have had two sessions of a legislature and a referendum since then. You answered that in part with Senator Heinz, arguing that the state probably wouldn't vote for it anyway and it seems to me you ought to have a chance and we ought to know how the people of New York feel about supporting their city.

Gov. Carey. Well, the people's attitude on further extension of credit is a wary one, witness the fact that we put up a $750 million issue to create jobs and employment and it was voted down.
The Chairman. That's something I think we ought to take into consideration in judging whether or not the federal government ought to go along.

Gov. Carey. Please don't blame that on the people. Blame it on the Governor. I failed to be specific enough on the identification of projects that would be funded by the monies and the people, lacking specificity, decided not to provide that credit. So the people now are doing just what you're asking. You want specificity and we are here to provide it.

Senator Moynihan. Could I just point out that that's the first governor since Al Smith who said, "Blame it on me." That's the kind of Governor we have. It's different than it was and better.

The Chairman. Well, I agree he's certainly a great governor and I think he's right in the great tradition of -- you, incidentally, by saying Al Smith, you say Al Smith was a greater governor than Franklin Roosevelt, but I think that may be the case.

Senator Moynihan. That's right.

The Chairman. Or Herbert Hoover or Tom Dewey.

Senator Moynihan. Just like you're a greater Senator than Bob LaFollette.

The Chairman. Or Joe McCarthy.

Maybe it would be difficult for the state to do more to help the city's long-term financing, but it seems to me you could
somewhat more with respect to short-term seasonal financing.

For instance, it's the opinion of some legal counsel that the
state could have acted on its own to bond out the state advance,
in effect, by pulling back the $750 million tax cut and using the
money instead to make a long-term loan to the city. There is
no prohibition against a loan of appropriated funds. This would
have cut the city's seasonal needs in half, and the state would
have made money on the loan.

What consideration did you give to doing this, or at least
to lending a part of the state advance money on a long-term
basis?

Gov. Carey. I didn't have to consider it very long. We
have a legislature which is one body which is under Democrat
control and the other is under Republican control. If I were
to go to the legislature and represent the entire state and say
that instead of a tax cut I ask for appropriation of funds to
be levied upon the people of the entire state to be applied for
a loan to New York City, I doubt very much if that bill would
have passed. It frankly would not have passed. It would be
looked upon as a gift of credit to New York City.

Furthermore, the $750 million tax cut phases in, as all
tax cuts do, and takes effect over a period of years. It does
not represent an accumulation of cash to be put in front or
into cash and put into a lump sum to be made available either
for loan or guarantee or any other form of immediate security.
The Chairman. Now take another possibility. Say you get the long-term financing you are seeking in some way or another and the city starts to bond out the state advance — $400 million in the first year of the plan, $100 million in the second year, is the present projection.

Since the state is already geared up to make those advances, couldn't you keep on making them in the amounts that were bonded out? This would permit the state to supply a substantial proportion of the city's reduced seasonal needs, to the extent that they could not be met in the public markets.

Gov. Carey. The history of that advance is we had to make it in May of 1975 to get money somewhere to avert default, so we constructed the $800 million advance out of the welfare payment and it rolls over each year and it has increased the state's borrowing by that amount and we charge the city for the interest on that borrowing. So we are supplying the state's credit for the short term and the city is paying the cost of that. To bond it out theoretically would produce the cost to the city of that $800 million advance.

The Chairman. Let me get into something else.

Gov. Carey. The rating agencies also look at that item as a short-term profit, something the state is supplying to the city, and to get back into the market they want that bonded out because that's really money owed by the city to the state, but we roll it over every year and annualized the postponement of
payments. So it's like the expense items in the capital budget. To clean it up it has to be bonded out.

The Chairman. The city has to pay interest on short-term borrowings anyway?

Gov. Carey. Yes, it does. It pays to the state the interest on the short-term borrowings. When we make them for the state it pays the interest. In this case it's paying at the state rate. The state rate the year previous was an attractive one. The state rate this year was somewhat higher.

The Chairman. Also, the state creates a big part of the seasonal problem for the City of New York and for the other cities in the state.

Gov. Carey. No question about it. That goes back to the Lehman-Dewey transition period and historians will account that it was during that time when he opened up what we call the magic window and somehow we lost, which is a very tricky thing to do, an entire quarter and it allowed one quarter of revenues without one quarter of expenditures to find its way into a comfortable nest into the Dewey budget. To undo that Deweyism in the Lehman-Dewey transition, we are prepared and we are trying in a time scale that we can construct to move away from this system where we borrow $3.6 billion to make the payments and to --

The Chairman. What kind of progress are you making in moving away from that? You make the borrowing in the spring.
Gov. Carey. The Comptroller has recommended that we change the entire state's accounting method and we move away from this system of borrowing and then funding on a seasonal basis the requirements for education and welfare and so forth of the localities. He has said in his recommendations that this would not be put in place, although we are willing to do it, before the year 1981, but we are certainly willing to move in that direction and do it on installment and phase it in as soon as we can.

The Chairman. Supposing we wrote into any New York City finance aid legislation a requirement that the state help meet the city's seasonal financing needs at some point in time in the future, either by amending the constitution or taking some of these other actions that you're talking about. Would you accept this condition of receiving additional New York City financial aid?

Gov. Carey. If you mean to synchronize the schedule of the state payments with the due dates that appear in the city, that's a reform that we would like to undertake, as long as you don't set the alarm clock and set it in such a way you don't give us time to legislate.

The Chairman. Are we talking about an alarm clock? We'd like to put in a specific date because if we don't do that, of course, it's just rhetoric.

Gov. Carey. The Comptroller in his recommendations to the
legislature indicated that we could not change the entire accounting system of the state, which we are willing to do, and synchronize the payments system and eliminate the spring borrowing before 1981. I believe that's the date he set. So if you put that in, I'm sure the Governor of 1981 would like to abide by it. Good luck to her.

The Chairman. Pat, do you have anything you'd like to say or ask?

Senator Moynihan. Just to thank Governor Carey and Mr. Rohatyn and Mr. Kummerfeld and express a thought that perhaps the Governor in 1981 might still be the same governor.

Gov. Carey. I'm not going to change my sex, but the office might.

Senator Moynihan. And thank you, Mr. Chairman, for your courtesy in having Senator Javits and me here.

The Chairman. Let me conclude by summing up the problem we have here. Governor, you have done a superb job I think since you have been elected to office in a very, very trying and tough time, one of the most difficult times in the history of the State of New York, and I think it deserves the thanks of everybody in and out of New York, to which you have contributed at a considerable sacrifice I'm sure.

Yet, I think it's fair to say the state hasn't done what it should do and here's why I say that. You still require the city to pay 25 percent of their welfare costs, far higher than any
other state requires any major city in the country to pay, and
that's an enormous burden.

You failed to amend the constitution to permit the state
to loan money to the city, although we specifically requested
that back in 1976.

How can it be said that the state is doing all it can when
it hands back what is probably the biggest tax reduction in the
country to its citizens at the very time when New York City, the
state's own responsibility, should have first claim, and then
you have the clearinghouse banks, the biggest banks in the
country, six of the ten biggest banks, obviously in my view
making a pitifully inadequate contribution. They are better
able to do the job than before. They are more profitable than
before. They are bigger than before. The city is in much
better shape than before. The state is in far better shape
than it was before, and yet they are actually reducing their
commitment to the city.

The pension funds did nobly and they deserve a great deal
of credit. Some people feel they have done too much. Maybe
they did.

Now when you come back to the federal government they want
to do a lot less.

So here's why, although I admire your eloquence and your
intelligence -- and I might add, your remarkable skill -- if
anybody can put a con job over on the Congress, it's the kind of
intelligence you bring here. I tried to add up the IQ of the people who are working on your side -- Javits, Moynihan, Carey, Rohatyn, Koch -- and it's a very high IQ, even if you add it up and divide by five it's pretty overwhelming. Then if you add in the power of the newspapers -- no IQ there at all, but if you just add in the power, everybody here -- almost everybody reads the New York Times and is tremendously impressed by it. New York has these bankers who are influential with our own bankers back in our own states.

I think this is the problem we have, Governor. I think that the members of the Congress may feel as I do that the State of New York and the City of New York could do more and will do more if the federal government doesn't step in and do it for them.

Gov. Carey. Why don't we do it together, Senator? Your recommendations are tolerable and certainly are the kind that we follow. You recommended that we do certain things that the federal government did when you, last came to our rescue, and we did impose tuition at the city university and we did increase the transit fares, and we have as a state assumed the cost of courts. We have picked it up from the city. We picked up as well, again in keeping with your recommendation, a larger share of the welfare payments. We have picked up some of that. We had a 50-50 sharing on the home relief program. That's part of what we picked up. We picked up the SSI supplementation which
the city was carrying. We are moving in the direction of your recommendations and certainly we take those recommendations into account and we therefore want to continue your valuable assistance in terms of recommendations which would not be available to us if we didn't have this proximity of Proxmire and Carey and so forth that's been going on.

We take them at face value and we certainly want to continue in that direction. I cannot assure you that the people will change their constitution in New York State any more than I can assure you that the ERA will become the law of the land in the United States.

The Chairman. We simply ask that they have a chance to try it.

Gov. Carey. We certainly would follow the recommendations very seriously and this is a matter for contemplation perhaps by a constitutional convention, but we don't have one in the foreseeable future.

Senator Moynihan. I just want to say that I have to meet with the President at the White House and I ask to be excused and to say that while I'm there I shall not fail to take up the question of the federal office building in Milwaukee which is before a subcommittee I have the honor to chair on the Government Public Works Committee. I don't want to miss that meeting.

The Chairman. This is the kind of thing I mean by the ingenuity and intelligence and sheer power of the New Yorkers
that come before us.

Mr. Rohatyn. May I say one thing, just for my own satisfac-
tion, before I leave? That is, this is not a con job, Senator. We have put together an awful lot of financing. We have paid everybody back. We intend to pay everybody back. I don't think we have ever kidded you. I don't think I have ever kidded you. I don't think we have ever kidded anybody. It isn't an easy thing to do. It isn't all that pleasant and sometimes we have been wrong, but I don't really think we have ever conned anybody. I don't think MAC has. I don't think I have. I don't think the Governor has. I don't think any of my associates have.

What we propose may be distasteful to you. It may not even be right. I really think it is right. But I wouldn't want to leave, as I said, especially at my last appearance in front of this Committee -- leave you with any kind of the slightest suspicion that I'm trying to con you because I'm not. I really think this is the right thing.

The Chairman. I know you are extremely sincere.

Mr. Rohatyn. I'm a sincere con?

The Chairman. We tend to be overwhelmed by your great intelligence, ability, your knowledge of the situation, and the fact that you have people with considerable authority and power and influence who enthusiastically support you, and we just have difficulty getting the other side capably represented. Thank you very much.
Gov. Carey. Mr. Chairman, if I may just say, had you not
been totally in command of the facts of this situation back in
1975 and able to present it to an adverse administration at that
time and to your colleagues in the Senate we would not have
survived the threat of 1975. For that, we are in your debt,
your obligation. I'm not conning the chairman one whit when I
say this because I well remember the strenuous hours and the
exacting time when you came to our aid and, frankly, your
surveillance of our activities over the ensuing period has been
most welcome because it's been fair and resulted in judgments
that have been helpful to us in making our way back to a better
day.

Let me close by saying that I don't relish the prospect of
asking for more assistance and I will be very straight with you.
In our business, in our profession, whatever it may be, we take
polls. We sense the public pulse and we try to determine what
is the sense of the people. Very frankly, the sense of the
people of New York State is that the Governor spends entirely
too much time on the affairs of New York City to the disadvantage
of the rest of the state.

To do what we have done so far, I will say it plainly, I
have placed my office and my career in political jeopardy but I
don't care about that. I don't want to jeopardize your career
in Wisconsin. I hope the people in Wisconsin will support you
when you support us. But, a frank observation, in order to
bring the state back I have had to do a number of unpopular things and that's quite evident in my standing in the state at this time, but given the choice between what is right and what is popular, I will continue to do the right thing, Mr. Chairman, and I'm not conning anybody.

The Chairman. Thank you very much, Governor, for a most impressive presentation. We greatly appreciate it.

The Committee will stand in recess until 3 o'clock this afternoon.

(Whereupon, at 1:20 p.m., the hearing was recessed, to be reconvened at 3:00 p.m., this same day.)
AFTERNOON SESSION (3:00 p.m.)

The Chairman. The Committee will come to order.

This afternoon we are really delighted to have the Secretary of the Treasury with us, who obviously has been rained on. But you are not all wet.

Secretary Blumenthal. I decided it was better to take a bath before than during the hearing.

(Laughter)

The Chairman. Mr. Secretary, you never take a bath during the hearings. We are very happy to have you. You are the man in charge of the loan to New York, have been ever since you took office. Of course the Secretary of the Treasury has that responsibility and we are very happy to hear your remarks.

I might suggest that you abbreviate as much as you can, and we will have your entire statement printed in the record. It is a very voluminous statement.

STATEMENT OF THE HONORABLE W. MICHAEL BLUMENTHAL,

SECRETARY OF THE TREASURY

Secretary Blumenthal. Yes, that was my intention, Mr. Chairman. I will just make some general remarks dealing with those aspects of the plan and our proposal that I think merit particular consideration.

I would say that our analysis and work on this difficult matter was based on four principles that guided us and that led
us to make the particular proposal that is before you.

One is that all steps possible must be taken to keep the City solvent. I will not here dwell on the alternative of bankruptcy. The President has repeatedly stated that that is not an alternative. I think everyone has agreed, I hope you, Mr. Chairman, and every member of the Committee has so agreed, nor will I go through the probable consequences of that kind of I think really unthinkable situation.

So clearly the first principle is what can be done to keep the City solvent and how can the Federal Government be helpful in that regard, doing so in a responsible manner.

Second, what are the maximum efforts that can be expected and must be expected from the various parties in New York, in the City, the State, and the various parties, the unions, the banks, the City administration, and all of those involved, because clearly that is where the primary and major responsibility must continue to lie. That was our second principle.

Third, what kind of a program. And I will come back to this point repeatedly, Mr. Chairman, it is very important. What kind of program is most likely to lead the City both toward real and true budget balance and do so permanently.

And, fourth, what kind of program will most quickly lead to continuing market access for the City, so that the Federal Government can step back and wash its hand of this matter.
That is something I think all of us would like to do as quickly as possible.

So any of the various proposals that we examined and considered over an extended period of time before we selected this one merely had as the background those four principles.

I think the 1978 situation that we face today, that is the second basic area I wish to address myself to, Mr. Chairman, is substantially different from the one in 1975. It is different because we have had three years of seasonal financing, and we have had a great many things happening during this period that really are at least in good part success stories.

I think we have to say that the things that have occurred over the last three years are generally speaking encouraging.

There is a table attached to my testimony that lays out the significant reduction in the deficit in the City that has occurred over this period. Taking this and analyzing and looking at it in terms of what would be required for true budget balance, I think significant forward progress has been made from $2 billion of deficit, a staggering amount for that City, down to about $750 million at the present time.

So we can say that the City is two-thirds there. The question, of course, is how quickly and how surely will the remainder of the distance be covered.

Secondly, I think we have to say that the City has done a great many things during this period, not only to reduce
its budget balance, but to demonstrate its capacity and willingness to act responsibly.

Perhaps it was justified in 1975 to have some doubts about that question, for certainly the actions up to 1975 did not fully reflect the capacity and willingness to act responsibly. But in the last three years I think that doubt certainly should have been removed.

The reduction in the work force by 60,000 people, the fact that the wage increases in the period '75 to '78 averaged 4.3 percent, which is certainly quite low, the fact that there was a substantial reduction in the number of hospital beds in the period '71 to '77, some 25 percent, the fact that they bit the bullet and substantially raised transit fares, the fact that many day care centers were closed and other social services curtailed, the fact that there was installed a financial management system which for the first time provides adequate timely information upon which management decisions can be based, and the presence at the present time of chartered public accountants, who are conducting tight proper audits which provide assurance for all those who have whatever stake in the City of knowing that the numbers that are presented are real numbers, and they can be relied upon.

So in addition to that, if we add to that the fact that the State of New York did a great many things during this period, quite apart from the establishment of the Municipal
Assistance Corporation itself, the increase in the budget assistance by the State over the period, which was substantial, some 10 percent over the four years, picking up the costs for senior colleges in the City, advancing the $800 million for seasonal funding, providing pledges for more aid in the future, which I am sure the Governor has testified to, and which he has assured me he thinks can be expected. And the most recent action of increasing the authority of the MAC to borrow an additional $3 billion upon the moral obligation of the State, which represents, after all, a commitment by the State, so that the total exposure of the State, if you look at it that way, now will be some $8.8 billion.

All of those things, I think, Mr. Chairman, do indicate that the capacity for responsible action, for action by the people in New York City and State, to do things for themselves, to move toward balance, and to correct the mistakes of the past, clearly has been proven and we can therefore have some reasonable expectation as we look to the future legislation that the commitments that will be made will be equally kept.

I should mention not unimportantly as the Secretary of the Treasury that the seasonal financing funds that have been advanced have been repaid on time, or early. And they have been repaid with the fees that were imposed. So certainly the record of the City in that regard has also been good.
I think the legitimate question then that can be asked is with all of these good things that have happened, why are we here and why do we still have this problem?

I think the problem, of course, is that there still is the deficit of over $700 million on a true and proper basis, based on generally accepted accounting principles.

Secondly, the one error that was made was the judgment three years ago that these steps that would be taken in the interim would lead the City to have access to the market again, the long-term market. That just has not happened.

So it seemed to us therefore that a plan that merited the support of the Congress, required first of all that there would be a believable budget that would close the remaining gap. That is required to get back into the market.

Secondly, that a long-term financing package be available for the market to see, which would assure the market that there is available a program for long-term financing and if these two things were done, then I think the Federal Government has reason to be confident that its objectives would have been achieved.

We worked with the City over a long period of time in the preparation of its four-year budget plan, and the details of that again are spelled out in my testimony, in table 3. Recognizing that a government budget four years hence is in any case somewhat conjectural in the out years, I have to say that
I am reasonably confident that this is a budget program that can be achieved. I am satisfied that for 1978, for the first year, that there will be balance. I am equally satisfied that the gaps that exist for '80 and '82, that are dependent on a variety of actions, some of which require legislation yet to be taken, are of a size sufficiently moderate, $362 million in 1980, up to about $700 million in 1982, that they can be closed, and again on table 7 there are details on the ways in which we think these gaps can be closed.

So I think as far as the budget plan is concerned, bearing in mind that we are phasing out these operating expenses that are in the capital budget, so that will be behind us, I think we have a program that we and the market can rely on.

I would say that the revenue estimates that underlie this program are conservative, based on past experience. Maybe we will do a little bit better.

I did insist that the City identify additional contingency actions that would have to be taken in case rather than being too optimistic they were too conservative. That has been done, and I am satisfied that we are in reasonably good shape as far as the budget is concerned.

Let me say a word about the labor settlement in that regard, for that clearly has an impact on the validity and the security that we can attach to the budget being in balance at the end of the period.
I must say, Mr. Chairman, that in most respects, in most respects, I am satisfied with that settlement, that that settlement reflects caution and responsibility on the part of the various parties. Four percent for each of those two years involving about a 6 percent increase in fact for the two years, a little more than 6 percent, is reasonable, given the fact that most unions are achieving increases in excess of that. I think that does show a sense of responsibility.

I want to point out three areas which I think a point needs to be made and perhaps some caution is in order. The first one is that that settlement, moderate as it is, is greater by about $140 million than the $617 million that was provided for in the plan that was presented to us.

As we have always indicated, offsets for that are needed. If the City, having made that commitment, has to pay these amounts, it has to find these amounts through savings in the City. We have asked the City, they have submitted to us a contingent budget for 1978, which is intended to reflect that, and I think that is probably reasonable.

I am concerned that the bonus for cost-of-living is not provided for in the 1981 and 1982. Clearly that is a challenge for the City, and that has to be worked out.

The third point is perhaps the most important. I must say I was somewhat disappointed that no agreement was included on the modification of work rules in the City. I had
hoped that through the cooperation of the City and the unions
some progress could be made in that area. Much has already
been done. I don't think anyone can legitimately claim that
there is not room for further improvement. I think that is
urgently needed. I think it can best be achieved through
cooperation of the City and the unions. I think that ought
to be done.

Personally I would like to see a goal established, a
target of what can be accomplished year by year through this
kind of labor-management cooperation, which is really a fine
tradition in this country.

I would further like to suggest if that can be done,
the amounts, even if they are modest, might be applied to debt
reduction. As we all know, one of the serious problems in
New York City is the staggering amount of debt the City faces,
and it has to be serviced, and labor and management together
can accomplish additional savings which would very well
serve to, even in a very modest way, reduce the amount of the
debt that faces the City.

Let me then turn, Mr. Chairman, to the financing
question for it is in the financing area that our proposal
to the Congress lies.

The City presented a long-term budget for capital
spending of $5.1 billion, and indicated that it would have
seasonal needs of an additional $1.4 billion in 1979, declining
to about $1 billion in 1982. We did not accept those estimates, we analyzed them in detail, we reviewed them with the City and with others, and our proposal to the Congress is based not on $5.1 billion, but on a program of $4.5 billion of long-term capital requirements.

In addition, we indicated, and our plan so reflects, that the seasonals could be met by the City from non-Federal sources. In other words, we are recommending that the seasonal borrowing of some $2 billion or a little more than $2 billion, that the Federal Government has previously provided be eliminated. And that in fact out of the $4.5 billion there be authority for standby guarantees of the Federal Government of up to $2 billion.

I suppose the key question, and I understand the question that you have been discussing here with other witnesses, and to which I wish to address myself, Mr. Chairman, is whether this is a reasonable proposal, specifically whether these funds could not be found in the City without the participation of the Federal Government, and also whether a program of continued seasonal lending might not have been preferable.

Let me go through what I think the reality of the market situation in New York is, as I understand it, and I have spent a fair amount of time talking to the bankers, the analysts, the financial experts, the people who follow the
market and who have a feel for it. At the present moment
the financial institutions have indicated that they can
provide a billion dollars of long-term funds toward that
$4.5 billion. I am encouraged that it does include $250 million
each from the savings banks and the insurance companies. I
was very anxious that these financial institutions step up to
their responsibility, and they have done so, considering that
they did not participate in the financing programs before, so I
think that is encouraging.

I think the $500 million that the clearing house banks
have indicated they will provide represents what I have
characterized as a good first step. I don't really believe
that that necessarily needs to be the last word. I think they
could probably do a little bit better. And I have indicated
to them that I hope something like another $300 million,
possibly $200 to $400 million, I don't know, but somewhat in that
general range, really possibly could be provided by them.

I think we need to bear in mind that in addition, under
the program we have presented, the clearing house banks will
be called upon to provide another $500 million for the seasonal
purposes. So that if we add these two things together and we
assume that we can convince them to come up with $800 million
rather than $500 million, the clearing house banks would be
supplying credit to the City of a total of $1.3 billion,
$800 million plus $500 million.
now the question that has been raised, Mr. Chairman, is why not more. If we could get sufficiently more we would not have to call on the Federal Government to provide this assistance.

In looking at the record, I find that the peak investment by the clearing house banks in MAC and City bonds, which occurred in late 1975, represented 22 percent of their combined equity. And the bank examiners, leaving aside the boards of directors, the bank examiners look upon this matter in terms of the percentage of equity pledged or loaned to a single entity. Twenty-two percent. If they were to lend $800 million, plus another $500 million short-term, in other words, $1.3 billion, that would represent at the end of the period 17 percent of their equity, rather than the peak of 22 percent, 17 percent of their equity, provided the equity grows 10 percent a year. I have had to make an assumption about what the growth in equity of these banks is going to be each year. That is not at all certain that it will grow at 10 percent a year. There has been some kind of a degree of stagnation in bank earnings, and in the growth in equity. If you assume that they will only grow by 5 percent a year, and that is another arbitrary assumption, I don't know what the actual numbers will be, then indeed the exposure at the end of the period would not be 17 percent, but 22.1 percent, in fact slightly higher than it was in the previous peak at the end of 1975.
The Chairman. And contrarily, if their equity grows
by 15 percent, it would be about --

Secretary Blumenthal. It would be even less, certainly.

The Chairman. Certainly 10 percent is a conservative
estimate, based on what they have been able to do.

Secretary Blumenthal. During certain periods it has been,
during other periods it has been less. You can establish a
schedule, Mr. Chairman, and just read off what it would be
under various assumptions.

I think the point that I wish to make is that just
looking at the numbers as to what these institutions would
be prudent to do, $1.3 billion for the clearing house banks
in my judgment is not out of line.

Now that leaves aside the very important question of
what the boards of directors actually authorize and what
is considered prudent by them, and we have to recognize, whether
we like it or not, that they are private institutions, and the
decisions have to be up to them, they must look after their
shareholders and if in their judgment they feel they don't
want to go beyond 17 percent or 18 percent, and don't want
to get back to that peak, I think I would have a certain amount
of sympathy for that, because that exposure has been very
heavy in the past, and we certainly don't want to contribute
to a situation in which the banks are dangerously exposed in
any direction.
Turning to the City pension funds now, we are recommending in our proposal that they provide up to a billion dollars during the period in unguaranteed loans, plus another $500 million of seasonals. So, again, unguaranteed, a billion and a half.

We estimate that that represents 26 percent of their assets being loaned to the City of New York on an unguaranteed basis, compared to their peak exposure of 35 percent.

Sell, again, I am not now counting the standby commitments they would make for guaranteed loans as well as the $250 million of guaranteed loans that would be added. Just the unguaranteed exposure would be a billion and a half dollars. And again, I suppose one could say well, why not 30 percent, why not 35, why not 40?

I would have to say, Mr. Chairman, that the Congress itself under existing legislation has made it very clear that it is unsafe for union pension funds to lend to any one borrower amounts exceeding 10 percent of their assets. New York City is a special situation, we have ourselves supported legislation before the Finance Committee I believe of the Senate, of the House, the House Ways and Means Committee, to have an exception to that. But I think prudent judgment is required here as to what the degree of that exception ought to be.

I think the unions did take a considerable risk to step up to 35 percent. I think it is again understandable; certainly
if I were a trustee I would have those concerns, of continuing indefinitely an exposure of 35 percent of my assets to any one lender. An exposure of 26 unguaranteed, plus some guaranteed loans is I think a somewhat safer situation.

Now we have taken these numbers as being reasonable, and in addition to that, we have taken account of the fact -- and that is a very important factor, Mr. Chairman -- that there is now no market for City bonds at all. I now come to the third point. There is now no market for City bonds at all. The City failed in November with a note of $250 to $400 million. It could not go to the market. The MAC, the last time it was able to sell a bond, did so in December, this was a moral obligation bond, and I think most observers would agree it was a bad experience, they had trouble getting rid of even $250 million and did so with some difficulty.

So what we have today in the absence of some kind of guarantees is a situation where there is no market for City bonds, and where there is a very limited market in our judgment for MAC bonds.

Under any plan, under the plan that the city proposed, under the plan that we proposed, and indeed under the plan that your Committee proposed, Mr. Chairman, there was a provision for a substantial amount of public borrowing, long-term. It is our judgment that it would simply not be possible for the City to go into the market and MAC to go into the
market to borrow these amounts of money even if we could get the necessary amounts from the banks and pension funds, and clearly their willingness to lend even these amounts depends somewhat on the Federal aid that will be provided. But they could not go for $1.7 billion, or $1.8 billion, whatever you or we suggested, based on the experience that now exists in the market.

If we provided merely seasonal funds, it is our judgment that the City would rock along, and we are sure we would be back in X years from now, or my successor would be back asking for a further extension, unless there is some kind of background glue provided by the Federal Government that opens up the public markets, so that those $1.7 billion, and eventually more, can be borrowed by the City and by MAC, we don't believe they can ever get back to the market.

Moreover, that has to be faced, that is another problem. You can't go from one day to the next, the market has to be opened up gradually, in the judgment of experts, and for that reason the availability of this kind of guarantee is required.

Now the guarantee that we are recommending be given, Mr. Chairman, has a number of important conditions attached to it. It would only be used as needed. In the first year we estimate if everybody does the right kind of efforts, that only $500 million would be needed. We would apply after that the best efforts test and certainly not extend any more than would be necessary.
The guarantees would carry a minimum fee of a half percent a year.

Third, they would be secured by Federal transfer payments to the City and the State, so that our exposure would be limited.

I understand some question has been raised as to whether or not the Secretary of the Treasury would in fact act upon this.

I can assure you that this Secretary of the Treasury would.

Moreover, the legislation as we have proposed it would mandate that, so even if he were disposed not to, as I understand it, he would be obligated to do so under the legislation.

Fourth, the EFCB has to continue with their full powers.

Fifth, the budget plan has to be approved and has to be balanced by 1982. And sixth, while we are asking for a maximum length of 15 years, we would, of course, try to negotiate a period of guarantees of a lesser time.

I think you know, Mr. Chairman, that the bonds that we are proposing would be taxable rather than tax-exempt.

Let me then conclude, Mr. Chairman, with one final point. I have the same philosophical concerns as others have and as I understand Dr. Burns expressed in a letter to you, the philosophical concern that Federal guarantees for municipal debts are a bad idea. I don't believe that that is a practice
that we should begin and expand. So philosophically I
would be at one with all of those who have that viewpoint.

The question really is whether or not the situation of that
City and the situation of the market to which it must have
access provides an alternative for getting access to the market
without giving some guarantees.

In our judgment, after a great deal of study, it does
not. Therefore, unfortunately, as in so many matters, while we
are philosophically most concerned about this matter, and while
we want to make sure that it can not and will not become a
precedent, we have to conclude that there is no other way
out, if you wish to get rid of this problem. If you want them
back in two or three or four years from now, you can keep
extending seasonal financing. But I don't really believe
that in that way we will get the City of New York out of
being involved with the Federal Government in this way.

Mr. Chairman, that completes my comments on the
legislation. I have a detailed analysis of it in my prepared
testimony and I will be glad to take any questions you or other
members of the Committee may have.

(The complete statement of Secretary Blumenthal follows:)
The Chairman. Thank you, Mr. Secretary. It is an excellent statement, a very thoughtful statement. You certainly covered a large amount of ground. Without objection, the entire statement will be printed, as I said, in full in the record.

Having said that, however, let me say I couldn't disagree more with your fundamental principle, which is that all four of these objectives will be best met by a guarantee.

Your second objective, as I understand it, is maximum budget and financing efforts by local parties, and your third is a truly balanced City budget as a prerequisite to assistance.

Mayor Koch sat in the same position you are sitting in the other day and he was asked what would happen if there was nothing forthcoming from the Federal Government, and he said he would do everything he possibly could to prevent bankruptcy, including making the sharpest kind of reductions and cuts.

I am convinced, in spite of the very powerful argument you have made, by far the strongest we have heard so far, about what the clearing house banks can do, that they are doing a pitifully inadequate job, far less than they can do. It is their City, and it seems to me rather than just calculate they can make 17, 18, 19 percent of equity loans to the City, they could do more.

I am convinced the pension funds could do more. In the
'60s the pension funds loaned 60 percent and more of their assets to the City of New York. So more could be done if they had to do it.

I think we haven't considered these alternatives. It seems there is a party line going here. I mean a party line. The position taken by the Carter administration, by the Treasury, is the position taken by the House, it has been the position that has been considered almost exclusively. I don't think we have really given adequate consideration to two alternative approaches which we might consider.

One was the approach taken by this Committee when it issued its report in February. We said at that time, as you may recall, that there are sufficient resources available in New York City and in New York State in the banks and pension funds for the City to make it on its own. Then of course there is the approach you mentioned, of Congressman Santanton and Federal Reserve Board Chairman Arthur Burns, which suggests we ought to consider the seasonal approach.

I just wonder how much consideration the Treasury gave these alternative considerations, and I want to ask some questions along this line.

In a report issued last February the Committee found New York City should be able to meet its financing needs after June 30 from resources available to the City and New York State without any further aid from the Federal Government.
We found that the six largest banks could easily invest over $2 billion more in City or MAC obligations over the next four years just by returning to their 1975 level of investment of .92 percent of assets.

We found the pension funds could provide about $2.6 billion just by maintaining their present level of investment of 5 percent of assets.

No one has refuted that arithmetic, nor can you deny the banks and pension funds have an enormous stake in the City's solvency.

Why shouldn't the banks and the pension funds back up the City's financing needs to the extent they can not be met in the public markets under these circumstances, in view of the fact that this is an extreme situation? This isn't that they go along if they can. It is their City, they have the biggest stake involved here. Why shouldn't they be called upon to do more?

Secretary Blumenthal. Mr. Chairman, let's turn to the pension funds first. If the pension funds were to maintain 35 percent of their assets in New York City or MAC unguaranteed securities, it would mean that they would have to purchase $2.7 billion in New York City securities in the next four years. That would mean that it would leave the City pension funds with $5 billion invested in New York City and MAC securities at the end of the four-year period, which is more
than one-third of the City's aggregate outstanding debt.

As I have said before, throughout the years, and most recently under ARISA, the Congress has legislated a standard that requires pension funds to diversify their investments, ten percent in one issue is the maximum —

The Chairman. You are talking about private pension funds.

Secretary Blumenthal. Right.

The Chairman. There is no law affecting public pension funds.

Secretary Blumenthal. I would have to say the philosophy behind that stricture applies to all pension funds, for it is designed to protect the beneficiaries.

The Chairman. That may be. But I am talking about what Congress has done, Congress did with open eyes. We have to recognize I think that the public pension funds are different, and indeed their commitments are different. I don't think the position taken by the City of New York in the past, in 1960, was necessary wrong, when they put 60 percent of their assets into their own City securities. It is their city.

Secretary Blumenthal. Mr. Chairman, I agree with you the situation is quite different in the case of New York. It is for this reason that I wouldn't for a moment suggest that they reduce that exposure to 10 percent. I think 26 percent is not an unreasonable one, and I think, moreover, we
have a problem that the trustees who are really liable have
to make those judgments as best they can. And we simply have no
assurance that those trustees will in fact agree with you.

In fact, everything that I can hear is that they will
not agree with you, that it is proper for them to continue
to invest that much.

The Chairman. I agree wholeheartedly that if they have
the alternative of the Federal Government coming in with a
guarantee which relieves them of making that kind of commitment,
they will take that alternative of having the Federal Govern-
ment come in.

Let me ask you about the clearing house banks. What have
you done to get the banks involved? Have you negotiated with
them, have you asked them what conditions are necessary to
enable them to come in in a bigger way than they have?

Secretary Blumenthal. Mr. Chairman, yes, we have
negotiated with them. I have made it clear to them that I
consider the $500 million to be a good first step. The fact
that I so indicated to you here --

The Chairman. I am appalled at that. How can you consider
$500 million to be a good first step? Mr. Rohatyn, who has
been close to this, is very expert, he is a banker himself,
he has the respect of the New York banking community, he was
unimpressed by that, he didn't think that was adequate, the
Governor didn't think it was enough, it is far less than they
had before when the City was in worse shape. How can you
say $500 million is a good first step? It seems to me
it is pitiful, a step backward. I know you don't want them
to go backward.

Secretary Blumenthal. No, we have a total commitment
of a billion dollars. I think that can and should be improved
upon. And I think that if you bear in mind that there is another
$500 million of seasonal financing which is unsecured, that
they must now step up to, which they haven't previously done,
you then have a total of $1.3 billion, if they go to $800
million, and I think that is a reasonable amount for these
banks.

They have boards of directors and fiduciary respons-
sibilities to their depositors. As I indicated as a percent
of their equity, it is a fairly high percent. Depending on
how fast the equity grows over the period, it could be as
high as it has ever been, if it grows slowly. Or it could
reduce it somewhat.

I would be delighted, Mr. Chairman-- the bottom line
is this: If you know of a way to induce the fiduciaries
of, the trustees of the pension fund to put up what is
necessary, to obviate any participation by the Federal Govern-
ment, and know of a way to force the banks to do that--

The Chairman. Let me suggest, as you know, as you
indicated, you have great respect for Dr. Burns, as I do, I
doubt if there is anybody who has more understanding or more
concern about the condition of our banks than he has. He suggested the other alternative, he suggested that we have a seasonal loan phase-out, phased out starting at something like $1.6, going down to $1.2, and then to .6, and then out. And he felt that would be proper. He felt that the City could get back into the credit market. He felt that this is something that can be done without endangering the banks. He felt they ought to be challenged to do that kind of thing.

Secretary Blumentahl. Mr. Chairman, I read Dr. Burns' letter very carefully. Dr. Burns says the City needs help, and he thinks that the help should be given short-term seasonal rather than long-term, because he is philosophically opposed to long-term guarantees. He has no analysis that I am aware of in that document as to how that is to be done or why that can be done and I am not aware of the fact that he has devoted the kind of time that is required to analyze that market.

The Chairman. I think that is a fair statement. I talked to Dr. Burns at some length about this. I think Dr. Burns, as you know, is a man of considerable intellectual capacity and ability and judgment, and he is not a babe in the woods when it comes to this situation in New York. He has observed it for a long time. He also speaks with considerable prudence and caution. He is not going to rush in and say oh, they can take care of it by cutting it down in some arbitrary way. He is a very thoughtful person. He wouldn't write a letter
like that to this Committee just on a notion without adequate study.

I think we have to place considerable trust in that and I would think the Secretary of the Treasury and the Congress would give that alternative more careful and thorough consideration than we have given it so far.

Secretary Blumenthal. Mr. Chairman, I have the greatest admiration for Dr. Burns, I have worked closely with him, and I admire him greatly. I don't always agree with him. I understand that that is the case --

The Chairman. I disagree with him more than I agree with him.

Secretary Blumenthal. I understand that is the case for the Chairman of this Committee as well. He must be delighted to hear the high praise that is being heaped on him in this regard; that is not always the case.

Senator Schmitt. Our Committee is always very selective.

The Chairman. Nobody is perfect.

Senator Schmitt. Speak for yourself, Mr. Chairman.

Secretary Blumenthal. I assure you that we began with the notion that why not just some seasonal funds, and why not just phasing out. We spent a great deal of time analyzing this problem, and I hope that you have a certain amount of faith in my being thoughtful about these problems.
I made that decision and recommended it to the President, it was based on a lot of analyses of other alternatives, and I came to the conclusion that if we were to get the City back into the market, we couldn't do it with continued short-term financing, we would be back in four years asking for more.

The Chairman. My time is up. Senator Heinz.

Senator Heinz. Thank you, Mr. Chairman. Mr. Secretary, when Mr. Rohatyn was before us this morning, I asked him if he agreed with the assumption that if the City did receive seasonal financing, that they could re-enter the public market by the end of the four-year period. He did not dispute that assumption, although the record is unclear that he went on record in agreeing with it. Nonetheless, it stands to reason that if the City can balance its budget as they propose to do by fiscal '82, that they would have every reason to expect and in fact every reason to realize the fact that they would be back in the market.

Now your office and you were very kind and very helpful and have made available to me today an analysis that you and I talked about some months ago. I understand that you couldn't provide it until the City provided you with certain numbers. You have those numbers now and I know your office did the analysis as fast as you possibly could. It is an analysis as I understand it of the difference in costs between a
seasonal approach and the Administration's approach. The bottom line, as I understand it, is that if you make the assumption --

The Chairman. Will the Senator yield? Can we make that a part of the record?

Senator Heinz. Yes, I ask that the Secretary's letter of June 7, 1978 be made a part of the record.

The Chairman. Without objection.

(COMMITTEE INSERT)
Senator Heinz. If you make the assumption that in fact the City can borrow the $3.7 billion needed over the next four years -- and this is a key assumption -- that the incremental cost to the City, the incremental net cost to the City over four years is a total of only $98 million, less than $25 million a year. So it is clearly, in a City which has a $13 or $14 billion budget, not a big expense.

So the question is: can they do it. And the question is what happens if we go seasonal loans. And in fact, what happens to the borrowing of the City, because this becomes the crucial item.

Now Mr. Rohatyn did suggest that it would be possible for the City to borrow not $3.7 billion, which is the assumption you made, but $2.5 billion over the next three years. That is a difference of $1.2 billion, and would necessitate in effect the postponement of about two years worth of capital projects. It would also have the effect of lowering the City's net borrowing costs by somewhere around $150 or $200 million, assuming 8 percent borrowing cost, assuming that it is done, it is averaged out over a three-year period, that is the ballpark figure.

And the issue then becomes how grievous, how big a problem is that to New York? It would actually result in a lower operating cost for New York, it would result presumably in their ability to balance their budget more easily by 1982.
No one claims it will be easy in total. But it does, I think, support the assumption that Mr. Rohatyn agreed to, as I understood him, that the City would be able to enter the market now and in 1982, even with seasonal financing and not with the guaranteed loans.

Now, the other side of the question is whether that kind of a program has additional benefits. I think Senator Proxmire has referred to one of the benefits, which is the maintenance of the strict principle -- and it has been strict heretofore -- of Federalism, in Federal-state-municipal relations.

There are probably other virtues as well, one of which is the desire that I think you share with many of us, which is to keep the City on what might be described not as an umbilical cord, but on a short leash.

Yesterday Mayor Koch, President Bellamy, and others complimented the Committee on giving them the reason and helping them be tough and as a result they felt this had been useful to them in the various kinds of negotiations, various kinds of decisions they had to make.

It seems to me therefore that while there may be some difficulties which we haven't been able to assess, either quantitatively or qualitatively, with the postponement of some of the capital expenditures by the City, there are some advantages that might or might not, depending on one's point
of view, offset that.

Would you care to comment on that analysis? Do you see it flawed in any way?

Secretary Blumenthal. I don't know whether I can do full-justice to all of the elements you referred to, but I will do my best.

Let me deal with the question of the short leash first, the last point. I think it is possible to construct a situation under which the pressure on the City, if you will, to conform to the goals that are set, to balance the budget, to take responsible actions, is just as great under a guarantee program as it is under a seasonal financing program.

There are a variety -- quite apart from the EFCB's continuation and the fact that the unions certainly are anxious to cooperate to get rid of the EFCB, which means that all of these goals must be met, and quite apart from the fact that all of this means that there is a lot of emphasis in the City upon responsible action to eliminate that, there are things that can be written into the agreement.

For example, the fact that the Federal Government would automatically be required to participate in EFCB deliberations in the event of a default of the covenant. Possibly the suggestion which I understand Senator Javits has made, that there is a right to accelerate the underlying obligation in the event of a City default through the maintenance of a special
account or a funded reserve fund of some kind. So I think that probably can be worked in.

Let me turn though to the main question, which is whether or not -- this is really the key issue -- whether or not the City can, from a variety of sources, get enough long-term lending in order to handle that part of the problem on its own, if we provide some seasonal financing.

You have to begin with facts. The facts are that there is no public market at all at this point for any unguaranteed City securities, in spite of the fact that there has been a seasonal loan program in existence.

The City tried, the City failed. There is no reason to believe that that will change.

I should say that even as the market opens up, it is a fact that financial markets open up gradually, you can't go from one day to the next, you have to go very very slowly.

So you have an important period in the interim in which you would have a gap.

The market for MAC securities is very very limited. Witness the difficulties that MAC experienced, Mr. Rohatyn experienced, in doing a $250 million bond issue last fall.

Senator Heinz. If I might just interrupt you briefly, there is reason to believe that there was a considerable amount of uncertainty as to what the Federal Government would do at that point. There was no assurance that seasonal
financing would continue, and there was clearly a great need for something to take place.

So while you are quite right in your empirical observation, I wouldn't want one to think that absent seasonal financing, Mr. Rohatyn I think suggested as much, that there would not be a substantial market for MAC bonds.

Indeed he seemed to indicate there would be a market for $2.5 billion over the three years.

Secretary Blumenthal. But to get the City back in the market, which is out of the market now, that would be very difficult. What the degree of market for MAC is we really don't know. Maybe it would be better.

The second thing is that everyone, that is, MAC, the City, the EFCB, the Treasury, and this Committee, agrees that in order to properly finance the capital needs over the next four years, the City and MAC together have to sell about $4.5 billion worth. There has been no disagreement on that point.

I won't go into the gory details of the state of the City's capital plant, I am not that expert in it, I only just use visual evidence and there is certainly plenty of that to go around. We don't see how the long-term market is going to open up insufficient amount -- it has to be the long-term market, otherwise the City will continue to borrow short, continue to have this problem -- unless something changes in this situation.

Now I suppose we could say that possibly the fact that
there is by generally accepted accounting principles a
balance in 1982, that will be sufficient to open up the market.

Now if it did, it would be very gradual. You know how
financial markets work. Once they have lost confidence, to
re-establish it is not a one-day proposition, you try with
a couple hundred million, when you have digested that you
go for more and eventually you get back in.

Senator Heinz. I used to know how the financial markets
worked, until I got into government and I found that government
could borrow endlessly, no matter what its deficit was. But
that was something I hadn't realized before, I am still not
too certain about it.

Secretary Blumenthal. The financial institutions, that is
the banks, are committed now to put in $2 billion, $750 million
from the banks, $750 million from the pension bunds, $500
from financial institutions. I said $800. Roughly $2 billion.
That leaves $2.5 billion as the gap. That is really the
crux of the issue. We don't see how, and I really would
doubt that Mr. Rohatyn, I would be very surprised because he
was the first one to come to me and say I can't do it, he
said he needs a guarantee. And at the time I took that as an
assertion, and really came to it reluctantly after a lot of
analysis.

We don't see where the two and a half billion gap will
come from if the market is not open. We could get short-term
Federal loans to keep the City afloat, but not a long-term solution.

That is really the crux of the problem. We would be taking a chance that four years from now that situation would have changed. I suspect at best, and perhaps this is something we have to consider, at least we would be in here four years from now asking for some further interim financing.

I think it might be beginning at the end of the four-year period. But I really don't know, and this is my final point, Senator Heinz, seasonal financing is better for one reason and one reason only, and that is the philosophical one I think we all agree on, which is a Federal guarantee is really not a basically good idea.

In terms of the Federal government's position actually, I think we are financially as well or better off with a long-term guarantee. We don't have to put the money out, which in turn we have to go and borrow, we use our signature, if you will, and I think it puts a lot of pressure on the City to move on from there.

I really think it is as good or better a system and one that is more assured, if we make it clear that they can not come back, Congress makes it very clear that that is the end. It seems to me that is what is required to get out of this otherwise interminable problem.

Senator Heinz. Mr. Secretary, thank you, my time has expired.
The Chairman. Senator Riegle.

Senator Riegle. Thank you, Mr. Chairman. Mr. Secretary, yesterday when the Mayor and Comptroller of the City of New York were here and other officials from the City, they discussed with us what would happen at the end of the fiscal year if some steps are not taken to make some kind of Federal loan guarantee assistance available in the coming fiscal year.

I want to review with you just briefly what they said to us, because I would like your assessment as to what they had to say yesterday is what you as well would perceive.

They indicated that when the current program expires, and we move into the month of July, the Mayor said if there is no further help from the Federal Government available, he will begin the kind of cutbacks, emergency cutbacks in order of priority to try to keep the City solvent for as many days as possible. And the problem is that within a matter of two or three weeks the City is overtaken by the need to roll over certain debt that comes due. And then the Comptroller indicated at that point he would not be able to refinance debts that were due, and at that point there would be a technical insolvency moment arrive where the City in effect would no longer be able to meet its bills and presumably would meet the test of insolvency or bankruptcy.

Is that your sense for what we face if no action is taken?
Secretary Blumenthal. I didn't read the precise testimony of Mayor Koch, but I am almost certain what he meant by the cutbacks is of course he would cut back, but it would only be a matter of delaying it for days.

Senator Riegle. Days or weeks. He also made it clear, I might say on his behalf, that he would do that in keeping with a pledge he had made that he would take every action he could to avoid insolvency. But at the most it would buy a matter of days. Is that your sense for it as well?

Secretary Blumenthal. That is my sense. We have thought about what the consequences of this action would be, default, and they are disturbing to say the least.

The City under those circumstances would not be able to meet either its long-term or short-term financing needs, and pay its bills, it would not be able to get any funds from any lenders, obviously nobody would lend money in that situation, and the pressure on the Federal Government in that situation, to provide the necessary funds just to keep going would be enormous and the costs would far exceed any of this kind of legislation.

There would be, first of all, complex questions of priorities, who gets paid first in that situation. The very existence of MAC would be in question, as to when they would get paid. You would immediately be deluged with litigation involving all parties that have any kind of contractual or credit
relationship with the City of New York. Creditors would be frozen in without payment for a long time. The City's ability to issue certificates of indebtedness to raise funds to provide essential services would be in doubt. You can go on from there.

You would have a bankruptcy judge in charge, with all that that involves.

Senator Riegle. Do you see any pluses at all from the City having to go through this kind of a thing? Is there any other side of the ledger, so to speak?

Secretary Blumenthal. Well, it has been said that that terrible situation would be a good lesson to other cities in the country. I must say the price for teaching other cities that lesson is unacceptably high.

Senator Riegle. I think so too. It seems to me the price that New York is now paying, it had to surrender as much operating control over its own affairs as it has had to try to work its way out of past difficulties, is a rather high price as it is.

But as Secretary of the Treasury, as one who is in touch constantly with the governments of other countries, and who deals at that level with matters of international finance and economics, I am wondering what the reaction, the implications would be worldwide, if suddenly the City of New York, which is the largest city in this country, would become
insolvent, and the Federal Government demonstrating an
capacity to form any kind of partnership to respond to the
problem, what kind of reaction would be anticipated in terms
of how this would affect our standing in the world today, given
the fact that we have a few other problems with balance of
payments and things of that sort?

Secretary Blumenthal. I think it is a very important
issue, Senator. And I have to be careful how I answer it,
because I am obviously talking about a situation which we
have never experienced, and I hope would not arise.

To the rest of the world, New York City in many ways
is synonymous with the United States. It is the world financial
center, Wall Street is almost a generic term. It would in
my judgement be very disturbing to all those foreign entities
who have invested in this country, and who deal with New
York, deal with Wall Street, to see a situation in which we
apparently are not able to keep our largest most important
city and financial center afloat.

And the details of it would be lost on the foreigners.
I think the impact on not only our standing, but I would have to
say our currency is something that could be serious.

Senator Riegle. I share that concern. In addition to
that, it seems to me that there is enough evidence piling up
of international concern about the capacity of the United
States to respond to problems today, just the whole question
of confidence in our leadership in terms of dealing with both international as well as domestic problems, that if we were to suddenly find ourselves with this as a major new problem, to have to struggle with it, that I think this would do us great damage abroad.

I am afraid that point tends to get lost in terms of a lot of the discussion we have had so far. Let's take, apart from the seasonal loan guarantees, of which there seems to be some kind of majority here, I think I hear that, in terms of at least a willingness to consider an extension of that type of loan guarantee, but taking the long-term loans, as I understand it, in fact you would have to make the decision as to when and where long-term guarantees would apply. Is that correct?

Secretary Blumenthal. That is correct.

Senator Riegle. I am interested in how you would assess, and how you do assess the degree of risk to the Federal Government on the repayment of those kinds of loans which the Federal Government guarantees, versus the seasonal kind.

To make it more pointed, let me just say one other thing. We have had some period of experience with seasonal loans, where they have all been repaid. The Federal Government has not only gotten all of its money back, we made some small amount of money on those transactions. To the extent anyone has
a concern that the long-term guarantees might somehow present
a greater risk of default or the Federal Government would
end up left holding the bag, what is your assessment of the
risk of just that portion of the loan guarantees that
are being requested here?

Secretary Blumenthal. Actually, Senator, I have not heard
anyone serious suggest, and I think for good reason, because
it would not be justified, that a long-term guarantee repre-
sents a greater risk. The risk is the same. We have insisted
that the Financial Control Board be in existence for as long
as there are guaranteed bonds out, so we have the same
assurance with them.

Senator Riegle. So you have everything tied down in
exactly the same fashion throughout the duration of the
loan, whether it is a seasonal loan or a long-term loan?

Secretary Blumenthal. Right. If we have a commitment
in the law, there would be a commitment that we could attach
transfer payments to the City first and then to the State
in the event of default. So we have that assurance, which
indeed we have in the seasonal program as well. It is no
different.

Senator Riegle. So as a practical matter, is there any
real risk of those loans not being repaid? In other words, is
there an authentic risk that the Federal Government might
have to come forward and make good in a default situation?
Secretary Blumenthal. When you lend money there is always a risk that the borrower won't repay. But the risk is no greater in one program than it is in the other. You can't say there is no risk.

Senator Riegle. I think it is important we talk about what kinds of things you envision in terms of this long-term money.

In other words, what is the money going to be used for, and so on?

Secretary Blumenthal. The money would be used for, the long-term funds would be used for true budget expenditures, as well as for what they call the bonding out of $800 million that has been advanced by the State, to make it possible for the State to lend more seasonal money, and for various other purposes that are spelled out in my testimony.

But we do have the security that if they do default, we have Federal transfer payments each year that we could utilize. The Chairman, I think at one point raised the question as to whether it would politically be possible to do it. If the law provided it, the Secretary of the Treasury would have to do it.

Senator Riegle. That is the point, if we write the guarantees in in the beginning, and we reduce the risk essentially to zero, in other words, if the controls are tight enough here, it becomes sort of a bogus distinction in my judgment
as between seasonal and long-term if the guarantees are the same. There may be a difference in terms of philosophy and I can understand why Arthur Burns or others might raise a question in terms of that differentiation. But when you are trying to work a city out of a catastrophe situation, and back to the point where it is a going concern, and can function in the private market in its own right, I don't think there is any other alternative.

The Chairman. Senator Schmitt.

Senator Schmitt. Thank you, Mr. Chairman. Mr. Secretary, the Administration late last year and early this year made quite an effort to sell what has been called the Panama Canal treaties. In New Mexico they were not exactly successful, but nationwide they appear to have been successful. Time will tell.

What general effort is being made by the Administration to sell this financing proposal to the country? We here on this Committee are creatures of our states more than we are very often of the country as a whole.

Secretary Blumenthal. I am not aware of any selling campaign that is underway, Senator. We have made no secret at all, through the testimony before the House and here today or our views, of our proposals, of the reasons for them, and we make that information available to everyone, but we have not gone out into the country to convince the people of New Mexico
or Indiana or any other state, or Wisconsin, of the justice and equity of this particular proposal.

Senator Schmitt. If you were down in the middle of New Mexico, Albuquerque, for example, what would you tell New Mexico about this? How would you try to enlist their support? I think you could probably say you don't want New York City to go bankrupt, do you, and they would probably say no. But then you start to get to the Federal Government starting to do something about the problem, then they will start to have a little heartburn with that.

What are you going to say to them, if I were able to persuade you to go out there and try to help me talk to my constituents?

Secretary Blumenthal. Well, I hesitate to tell a senator what he ought to say to his constituents --

Senator Schmitt. No, I want to know what you would say.

Secretary Blumenthal. I would say, you know, when you are there in Washington, you learn all kinds of things and you find it is tough, these are tough problems. If New York City goes bust, there is a very good chance that the securities that we are floating out here are going to be more expensive. If New York City goes bust, there is a very good chance the dollar will be more unsettled. If New York City goes bust, it may mean our foreign policy objectives can not be as easily met --
Senator Schmitt. But they have already agreed, I think in general, that New York City shouldn't go broke. They don't want to see that, even though we get a lot of New Yorkers moving kto New Mexico because of the problems of New York City. I think generally they would agree on that. But how is this going to solve the problem? They are concerned that we have been through one attempted solution, and they want to know, you are asking me to support you in going through another solution. And why is this one going to work.

Secretary Blumenthal. On that one I would say we gave them seasonal loans if they would do certain things, and we expected that to open up the market for them. They did those things, but the market didn't open up. Our best minds have analyzed this problem, and have come to the conclusion that if we change the program somewhat, we can get them off our backs and this is how we will change it.

In other words, I would explain how the seasonal financing is different from the long-term guarantees, and how the long-term guarantees will provide the Federal glue in the background to put that City back in the market so it can stand on its own feet.

Senator Schmitt. Then they might ask, if we got by that particular explanation, how are you going to judge the success of this particular program, so that if it is not working you will know it is not working, and then try to find something else
that you hope will work.

Secretary Blumenthal. Well, the failure of the program will be exemplified by essentially my being proved wrong, or those who advocate it being proved wrong, and the market still won't open up. That would be three or four years from now when we would know that, or we would begin to know it even before that.

I don't think that is going to happen. I don't know what we do in that situation, I really don't know. But I am sure that the seasonal financing is not going, if we continue that, it is not going to accelerate getting the City back in the market, that we know, we have seen it hasn't worked.

So when something doesn't work, I suppose you try something else. If that doesn't work, you have to come back and scratch your head again.

Senator Schmitt. You really think it is your silver bullet with respect to New York? If this doesn't work, then it is basically a Federal take-over of the City?

Secretary Blumenthal. Oh, heavens, I hope not, Senator.

Senator Schmitt. But you left me hanging. You said if it doesn't work, we will have to find another silver bullet.

Secretary Blumenthal. You know, that is true about anything you try, if it doesn't work, you have to try something else.

Senator Schmitt. My training and background is you try
to think through the alternatives to success as well as the alternatives to failure, and try to anticipate what you are going to do if failure happens to be the alternative that occurs. And I would feel a little more comfortable if I knew you had a back-up plan, just as I was more comfortable in another set of circumstances when I knew there was a back-up propulsion system or something like that.

Senator Riegle. Would the Senator yield briefly at that point?

Senator Schmitt. I would be happy to.

Senator Riegle. I appreciate your yielding. I think what is significant is the seasonal loan program has been in place and it has worked to a certain extent, the monies have been repaid, they have been repaid on time. The deficit in the City of New York has been narrowing. In other words, they are making progress, they are working their way back.

What has not happened is they have not been able to establish this financial sufficiency in terms of the private market to be able to go out and borrow money such as Albuquerque or other cities are able to do.

So the question is now do we make the next leg of the journey, how do we get down the road so we get to a point where they are able to establish that outside creditworthiness.

It seems to me we have accomplished part of the assignment, but we have not yet accomplished all of it.
Senator Schmitt. But, Senator, and Mr. Secretary, it is my understanding we really haven't made much progress on curing the basic ill. The budget is expanding, we have seen some more wage settlements that seem to be a little questionable. It is a City problem, we are not seeing everybody in the City really pulling together to solve it and start to reduce some of the basic trends.

Secretary Blumenthal. Senator, I really think, and I summarized that in the beginning of my statement, we have made a lot of progress. The City has made a great deal of progress. That budget was out of balance by $2 billion. They had certain targets as to how it would be reduced. They have achieved every one of those targets. It is down to $700 million. They have gone two-thirds of the way. They eliminated 60,000 jobs in that City, they closed 77 day care centers. I gave a whole list of things.

I would be glad to submit that to you, the things that have been done. They have met all of their goals. In 1975, when this Congress considered this, there was one assumption made, and that assumption did not turn out to be correct, which is with these steps being accomplished, the markets would open up. The steps were accomplished, but the market didn't open up. So we are now trying something else.

As someone who is a social scientist by training, but who had responsibility for running an aero space company
and making some of the components that you referred to,
I know the problem. The problem is a little different in
this case, Senator. With aerospace hardware you can test
it and test it and you can have a failsafe and a third and
fourth and you can be sure it works, because it has worked
10,000 times before for reliability. You can't do that with
this kind of situation. You can only go by what the best
experts have worked out and judged to be a satisfactory
financial program.

Senator Schmitt. I am not sure the basic philosophies
have to be different. I think you still should be thinking
about the consequences of failure and the consequences of
success. You start to be successful, and all of a sudden
everything may get out of control again.

I guess my final question is what is your data base,
in order to evaluate the possibility of success or failure?
Do we really have a thorough audit now of the situation
in New York? Are you satisfied with that data base? Do
you think GAO, for example, ought to do an audit of this
whole situation?

Secretary Blumenthal. GAO has done an audit.

Senator Schmitt. Should they continue?

Secretary Blumenthal. They will do it periodically, I
am sure, if there is Federal involvement. We have a management
reporting system in effect now. We have chartered public
accountants that are doing audits, none of which existed before. The data base is not perfect yet, but it is vastly improved, and continuing targets have been set for further improvement. So it is reasonably good. It is getting better.

Senator Schmitt. Excuse me, I am a little bit unsure. Has the GAO, Mr. Chairman, provided the Committee with a specific audit of the New York City situation?

The Chairman. They have come in from time to time, we have had reports. They have people in New York who are constantly studying it.

As far as I know, we don't have any comprehensive overall audit.

Secretary Blumenthal. We have independent auditors that are doing that in New York City, which means it is one of the few cities that has independent auditors. GAO has made reports that dealt with individual situations, but has not made a comprehensive audit as the CPAs have.

Senator Schmitt. I think, Mr. Chairman, we might want to discuss that as a separate item, whether that would fulfill a useful purpose if it were done.

But my final question, and you can answer this quickly, I hope, what is the audit base upon which the Administration has based their present proposal? Are you taking the independent audit of New York City as the base upon which you stand now?

Secretary Blumenthal. We are taking the advice also of Arthur Anderson, who are in there for the Secretary of the
Treasury, auditing numbers, in order to certify, or indicate to us whether they are reliable or not, and whether we can base our judgments on the numbers that are provided. They are retained by us to do this job for us.

Senator Schmitt. Do they do an independent audit, or just review what is being done by the City and others?

Secretary Blumenthal. We have a 12 person office in New York City that works together with Arthur Anderson in insuring that the data base upon which we make our judgments is accurate and proper.

Pete Marwick works for the City, Arthur Anderson works for us; 12 Treasury employees are permanently stationed there.

Senator Schmitt. Has Arthur Anderson specifically evaluated the Administration's proposal against this audit base?

Secretary Blumenthal. They have looked at the City budget and the City's proposals for budget balancing and indicated whether the numbers are right, and whether it is reasonable. Arthur Anderson or no other auditing firm is in a position to certify that if certain things are done, the markets will open up, because that is an investment decision, and we don't know. You just go to investment bankers and ask them do you think that one year hence or two years hence you will be able to float those bonds. It is a matter of opinion.
Senator Schmitt. Thank you.

The Chairman. Senator Moynihan. Thank you, Mr. Chairman.

I wonder if I could just continue this conversation with our friend Senator Schmitt for a moment.

You are perfectly right to ask, but one of the extraordinary changes that has taken place in New York City in three years is that whatever the Eisenberg effect is, it is taking place in New York, because it is being watched more carefully than any municipal finances in history, or maybe nationally.

You have the Emergency Finance Control Board, you have independent auditors hired by the City, you have Arthur Anderson doing it for the Treasury, and then you have Treasury people auditing Arthur Anderson. I mean that is what you have.

About the citizens of Albuquerque, you might say two things. The first is that not having been there recently and seeing the growth in Albuquerque, I think you would find a very large number of people who have built new houses around the City, who have FHA mortgages. I think you would probably find most of them do. In the three years, fiscal '77, '78, and '79, it was reported in the President's budget he proposes to increase the FHA loan guarantees from $93.7 billion to $105.9 billion, which is about a $12 billion increase in loan guarantees. And all we are talking about here is a loan
guarantee, it is not a grant of money, it is a loan guarantee. It would cover the same table in the budget that FHA covers. You might say, and I think you might be well-advised to say—and I can give you this table right here to attest to the job you are doing. The State of New Mexico pays $690 million a year in Federal taxes, and receives back $3 billion $7 million for a 5 to 1 ratio, which is well done, and it is a good shot that $2.4 billion comes from New York, it really does, it always has.

Senator Schmitt. We appreciate that, that is why we are so concerned about the financial state of the State of New York and New York City.

Senator Moynihan. That is all I would hope from you.

Senator Schmitt. We want to be sure whatever you do, Senator, Mr. Secretary, and others, is successful.

Senator Javits. We won't be successful if dead, I assure you.

Senator Schmitt. We want to be sure the patient lives and the failsafe mode is not buried. We want it to be alive, and the reason we are going into these proposals is to convince ourselves that you are in fact going to be successful.

Senator Moynihan. Absolutely. I would like to say with respect to Dr. Burns, there is no one here I know who could hold him in higher esteem or greater affection than I
do, but he knows we have not always agreed, any more than the Chairman has always agreed with him.

In his letter, Mr. Chairman, Dr. Burns says "I believe in particular that a New York City bankruptcy would convey a salutary financial lesson to cities across our land." It is sort of like Dr. Johnson's remarks that at the prospect of hanging, one fully concentrates the mind, and the thought that the basic argument for public executions is it is an example for all of us.

I think his background teaching is that life is hard; I know life is hard, but I don't think we should bankrupt the cities.

Senator Schmitt. It is like practicing starving to death.

Senator Moynihan. That's right. His basic objection to these guarantees would be it is "a radical departure from the principles of fiscal Federalism."

Now, sir, I know as much about fiscal Federalism as Dr. Burns does, and that is not so. The radical departure from the principles of fiscal Federalism was the creation of the Tennessee Valley Authority under the New Deal. And there were many things done in the New Deal to which Dr. Burns is not yet reconciled, and I recognize that, and I admire his constancy, but the TVA settled that, and this is just the most minute increment to that.
Finally, sir, I want to simply say to the Secretary of the Treasury, you start out by saying this is a success story, in the last three years, and it has been a success story. One of the problems, the only real problem this country has is people never say thanks. I would like to say, speaking for New York, I would like to thank you, because you have been very much the essence to this success. It has meant a lot to this country and to our City.

I would like to include Secretary Carswell with you, and of course especially Mr. Roger Altman on your left, who has devoted himself utterly to this cause. You have been wonderful to us, you have not always been easy on us, but we have always known of your affection and integrity and we are grateful for it.

Thank you, Mr. Chairman.

Senator Schmitt. Mr. Chairman, because the table was brought up by the Senator from New York, I presume that was all Federal monies moving in and out of a particular state, is that correct, like research dollars? Because if one looks at the grants to state and local governments as a specific item within that, then New York is, I think, at $1.22 per tax dollar and New Mexico is $1.44 per tax dollar.

Senator Moynihan. That would be about right. But don't understimate that 22 cents.
Senator Schmitt. I am not underestimating it. But I think it is extremely important that New York survive. I hope we can be assured, by the time the Senate votes on this issue, that the plan we are voting on will in fact insure that survival.

The questions are going to be hard and tough, maybe even tougher than they have started out, but that is what we have to do.

Thank you, Mr. Chairman.

The Chairman. Senator Javits.

Senator Javits. Thank you, Mr. Chairman.

Mr. Secretary, I would like to join my colleague in thanking you on behalf of the people of our State and your associates. Politically, I never expected you to come up with this answer. It is the right financial answer, and I think I know New York City, and I know a little bit about business. But I really was surprised when you came up with the prescription like a doctor rather than like a politician. And that goes for the President, too, I will tell you that very frankly.

Now there are two things I would like to inquire into. And they are both disaster propositions.

You indicated you had some facts and figures on what would happen in New York if the Con-ress did nothing and you said it would affect our currency, the falling dollar is
no joy to any American, it is a great disaster for our country.

May I ask you this: Would it be possible from your public experience that the strains engendered by what New York would have to cut could produce a state of public disorder in New York?

Secretary Blumenthal. Senator, I am not expert in that kind of consideration, but I would think that if there were no possibility to borrow money at all, which is the situation that I have posited, it would mean that none of the City employees would be paid, and none of the services could be maintained. I think it goes without saying that police and fire protection would be in question. What the consequences of that are --

Senator Javits. And sanitation, health, basic trans-

Under those circumstances, Mr. Secretary, because Senator Schmitt asked us to look at the alternatives, because that is his business, and I was in that same business for a while, under those circumstances, and under your knowledge of the law as a Cabinet officer, would the Governor of the State of New York have the right to appeal to the Federal Government for disaster help, including troops?

Secretary Blumenthal. Again, I am not an expert on this, but I think if there is civil disorder, that he has that right.

Senator Javits. Exactly. As a Governor he can appeal
to the President to come to our rescue, and it is his
duty to come to our rescue.

I only raise that question, Mr. Secretary, because of
this matter of Federal-state relationships. If you are going
to push this to the wall, the Federal-state relationship is
going to be very very costly, as well as extremely disruptive,
as you have testified.

And then you have another part of your letter to Senator
Heinz that interested me. It occurs on page one. It says:
"As you undoubtedly have seen, New York City's physical plant
is literally falling apart."

What is your evidence on that?

Secretary Blumenthal. The City, as I understand it,
has been spending an average of less than $300 million per
year on maintaining the capital plant. I think the Mayor
would be in the best position to give you the specific
evidence. The evidence to which I was referring is essentially
one of just riding around the City and seeing the condition
of the streets, going over the bridges, and being told what the
condition of the sewers is, and of other matters that have to
do with the health and welfare of the people.

However, Senator, in that regard I might mention this
additional point, which is important. Insolvency of the City
in our judgment would most probably disrupt the entire municipal
securities market. Certain borrowers, particularly those of
large cities, would either be shut out from the market or
would have to pay higher rates of interest for their borrowing.
I think that is pretty clear. Smaller cities without strong
regulations or high ratings would also have difficult raising
funds, in our judgment.

So it would fall on the entire municipal bond market.
Individual investors who hold large amounts of city debt would
fact the strong possibility that the debt service payments
would not be paid to them.

International markets would become unsettled. The
commercial banking systems' exposure to New York City, as well
as to other places, would be severe and it would cut into
their ability to lend to others, because repayments would
not occur.

So I think it is important to recognize that that kind
of situation, quite apart from what it does to the City
itself, has a clear threat of a major impact on the country
as a whole. So it is of interest to everybody.

Senator Javits. Mr. Secretary, I remember when you
testified at the last set of hearings at the end of last
year. At the conclusion of one of those hearings when you
were on the stand I asked you directly: "Is it in the
national interest of the United States that New York City
should become insolvent?" Do you remember that question and
your answer?
Secretary Blumenthal. I remember it, and I gave an answer that I would certainly repeat, which is that it is not only not in the national interest, but in my judgment it is in the national interest that a solution be found so that the City permanently gets out of its difficulty and gets access to the markets again.

Senator Javits. And it is your financial judgment, not your political judgment, your financial judgment, that seasonal loans will not do that?

Secretary Blumenthal. That is the judgment that I came to after very careful study of the alternatives, including the continuation of seasonal financing, both at the present level and at gradually declining levels. I concluded that was not sufficient to get access to the markets again, and to get the Federal Government out from under this problem.

Senator Javits. And that the guarantee plan, which is the Administration's program, will do it?

Secretary Blumenthal. That is our best judgment.

Senator Javits. And you do not believe that the guarantee plan would deprive the Federal Government of the ability, which it now has, to closely monitor and control to the same extent that it is controlling now, the affairs of New York City and its financial operations?

Secretary Blumenthal. I don't believe it would deprive
us. I think the Congress could certainly in the legislation
insure that we have that continuing possibility.

   Senator Javits. Thank you.

Senator Riegle. Would the Senator yield at that point?

Senator Javits. Surely.

Senator Riegle. It seems to me there is another part of
the puzzle that was represented yesterday by the witnesses
and that is that there is also the question of leadership,
and the willingness of people to struggle with this problem
in leadership roles.

    It seems to me as long as we have a situation where it
is possible for the City to deal with its problems and work
its way back to a position of independent financial strength,
you are going to have the kind of talents available, people
who are willing to tackle those responsibilities in key elected
and appointed positions, struggling to make it happen.

    But it seems to me if the Federal Government were to
walk away and basically make it impossible for anybody to
work this problem out, that one of the first things that you
would lose, in addition to all of the chaos that has been
described that would happen, which I believe it would, is
that the people who are holding these leadership positions would
recognize, first of all, that they can't possibly make it
work, that it has been made unworkable, and it seems to me
it is that group of talented individuals who start to break
apart and drift away, because of the impossibility of the
task, and I don't know what we would forecast as coming in to take their places.

But I think your point about the Federal-state relationship is absolutely the case, because we are talking about 3 percent of the entire United States residing in what we call New York City. It is the 7 and a half million people you spoke about. And if we find ourselves in that situation, this is not a matter that the President of the United States, the Cabinet officers, can abandon. We have got people in hospitals that need medicines and care, in the City hospitals, and you have suppliers who are unwilling to make the medicine available because they think the bills are not going to be paid, obviously the Secretary of Health Education and Welfare will have to respond, and the President, I am sure, would direct him to.

I think the Chairman of this Committee and everybody on the Committee would support that kind of emergency response. But the point is that is not intelligent, that is not the smart way to solve this problem. It seems to me if we want to make New York City a permanent ward of the Federal Government, the best way to do it is to walk away from the problem now and we will re-inherit it in a matter of weeks.

Senator Javits. In a terribly aggravated way. It is the center of finance, communications, much of the culture, education, and medicine of this country, let alone a dozen
other things. Thank you, Mr. Chairman. Thank you, Mr. Secretary.

The Chairman. Mr. Secretary, I am concerned not only with the substance of what we are proposing here, but with the slack and soft way in which we are approaching it. I just don’t think Treasury has had the discipline or the muscle they should have had in this situation. I think we are just letting people in New York get off the hook and the Federal Government is stepping in.

Let me give you some examples. In your March testimony before the House Exconomic Stabilization Subcommittee you described your position with respect to the labor contract as follows: "Our general position is clear, namely, that any increases will have to be funded from productivity-related savings. We feel that is essential to a credible budget plan. Such a plan is a condition to the Administration's recommendations which I am presenting today."

You went on to say: "We do not favor the extension of any lending assistance to New York except on the basis of such a plan."

Now the City just agreed to a labor contract which did away with productivity criteria, which has no fringe benefits give-backs, which will cost the City $757 million over the next two years, for a total cost of $1.1 billion.

Furthermore, the unions have said they will seek
substantially larger increases for the final two years, 1981 and 1982, regardless of the City's financial condition.

It seems to me these factors cast serious doubt on the City's ability to balance its budget by 1982, and I think if we permit this, again, we are not living up to the commitment that you made, when you indicated that it would have to conform with the plan that has already been breached here.

Secretary Blumenthal. Mr. Chairman, I stand by that statement, and I made it clear in my testimony, as well as in my remarks, that I have indicated to the Mayor that the extra costs of that settlement must be found through internal savings; and that the total settlement must be financed in such a way that balance in '79 and beyond is assured.

In addition to that, I did indicate, and I am sorry if you consider me too soft in that regard, that I was disappointed that the question of productivity had not been addressed in the settlement. I indicated that I thought it ought to be, and I suggested that indeed any gains achieved therefrom might be applied to the reduction of the debt.

I do not have responsibility or authority to decide what the settlement is going to be. I think it would have been a serious mistake for the Secretary of the Treasury to inject himself or to try to take over a local labor negotiation.

The Chairman. We can see it will continue to get worse, the unions made no bones about it, they said it will, they
said in 1981 and 1982 they will be tougher, they said then
regardless of the financial condition of the City, they will
as for a substantial increase.

Having gone along with the breaking of the plan here,
with no productivity factor involved, with no give-backs,
it would seem to me we are in a rather weak position in the
future on this.

Let me ask you this: We had Mr. Rohatyn come before
us this morning, and admit what I think is a pitifully
inadequate commitment by the banks, $500 million, and even that
is based on nine conditions, most of which have not been met.

Furthermore, the seasonal loans approved in '75 were also
contingent on the City pension funds and they are refusing
to honor the bonding commitment they made in '75. They continue
to refuse to make some $703 million in City bond purchases
they were obligated to make, they pledged to make, they promised
to make. This causes question about the City's ability
to maintain the status quo.

If we know these local parties will not necessarily
comply with their financial commitments, how can we provide
long-term guarantees based on such commitments?

I think we have a program or plan here that makes it
tough for the Federal Government, makes it easy for the pension
funds, the labor unions, the banks, those people who ought
to assume the responsibility.
Secretary Blumenthal. Mr. Chairman, it is our position that the amount -- I have it as $683 million -- of long-term pension fund loans that were due before June 30, that that is a legally binding commitment. I have indicated to the City and the unions that we expect that to be made, that they are obligated to make it, and I have full expectation that will be done.

The Chairman. They have already breached it. Wasn't that commitment to be made by May 20?

Secretary Blumenthal. There was no specific date set. It has to be done before June 30.

The Chairman. It certainly has to be done by June 30.

Secretary Blumenthal. Yes, it does, and I have indicated I expect them to meet and fulfill that commitment.

The Chairman. I know the New York legislature finally passed and the Governor signed legislation to extend the Emergency Financial Control Board and increase the borrowing authority of the Municipal Assistance Corporation.

There are some problems with this situation, the taking authority over arbitration awards and impasse panels. I would think it is very important the Control Board have this authority, otherwise it is a very big loophole in the labor contract. As you know, if they don't have control over that, they could, and often in the past arbitration panels have provided settlements that were very excessive.
The authority in the EFCB extension bill would last only four years, for the next two rounds of labor negotiations. This certainly cuts down on the power of the Board to function as a long-term fiscal monitor.

Doesn't that suggest it would be preferable for the Federal Government to offer short-term financial assistance, if any, such as extension of seasonal loans, rather than providing long-term guarantees, which may not have an effective fiscal monitor to back them up?

Secretary Blumenthal. I would think what it might argue for, Mr. Chairman, is that the Federal Government require that effective fiscal monitor stay in operation not only for as long as the guarantee is outstanding, but also that its powers to deal with the impasse panels is not only restricted to the first four years, but for the entire period.

If the Congress made that judgment, I would certainly back it fully.

The Chairman. Well then you would say we should write that into the law, so we require the state legislature to comply with that as a condition of receiving the loan?

Secretary Blumenthal. I would fully understand why you are doing it, and we would accept that.

The Chairman. I am also concerned about the fact that the legislation is tied, the legislation they passed is tied to the Federal guarantee. It doesn't go into effect
unless there are guarantees. If there is a seasonal loan, it doesn't go into effect. The life of the Control Board is tied to the life of the guarantees.

What if we don't approve the guarantees, and that is our option, we may or may not approve them, and there is a strong sentiment not to approve guarantees, to go a different way, and we certainly haven't given any indication we will do so, although the House has.

Does this mean the legislation will self-destruct?

Secretary Blumenthal. I am not totally sure what would happen. I think they would have to scramble, if the Congress decided not to authorize us to provide the guarantees, but merely to extend the seasonal financing, for example, I think they would have to go back and amend the legislation. That is my impression.

The Chairman. Have you discussed this with them?

Secretary Blumenthal. We have made it very clear, yes. It is obvious that they would have to do that.

The Chairman. I am also concerned that the Treasury Department is supposed to review New York City's progress in implementing its new accounting system, and there has been a lot of talk about it. Maybe it has improved, I am sure it has in some respects, but it seems to be a long way from where it ought to be. Somehow the City keeps finding $100 million here and $200 million there, it seems to be turning
up somehow, more money this year to pay for labor contracts, more money last year to pay off moritorium notes. I think that raises considerable question about the City's credibility.

Senator Moynihan talked about all of the accountants and so forth, who are costing somebody millions of dollars to audit this and follow it. It doesn't seem to be very effective. I know that Mr. Phillips of Moody's suggested in our hearings last December that these ever-changing numbers were a problem affecting the City's ability to get a good rating on its bonds, and notes.

What is the status of the accounting system and why doesn't the City keep coming up with different numbers all of the time?

Secretary Blumenthal. They began implementing a new data base accounting and management information system on July 1, 1977. Three of the main subsystems have been implemented, that is, the budget, accounting, and the encumbrances. And these are functioning very well, the fourth, the payroll system, is to be implemented by the end of the year. Our assessment is that accounting information is now available, timely, and reasonably accurate. The management information will improve when the payroll system is implemented. And further training is going to be required for the management people who are operating this.

I agree with you that the lack of total precision with
regard to these numbers is disturbing. They have made some
progress, I think they need to make more.

I suppose it is just a matter of how long the learning
curve is from a situation in which they just were not trained
to do that sort of thing -- I would have to say, partly
at least in their defense, when you are operating that
large a budget, and where you are in fact projecting
receipts which are based on economic activity, there is always
a certain amount of --

The Chairman. There is some, yes. But let me
conclude by pointing out you have had a lot of experience in
corporate finance, you were head of Bendix Corporation and
you have been associated with other very large entities.

I think you wouldn't get a treasurer to last very long
with a corporation if he found a few million dollars there
and a few million dollars here, and said well, after all,
obody is perfect. You would insist on a much greater degree
of order.

Secretary Blumenthal. No, I am not going to defend that
system as being totally adequate. I think it has come a long
way. It has some further distance to go, I agree.

The Chairman. Senator Heinz.

Senator Heinz. Thank you, Mr. Chairman. Mr. Secretary,
is it unusual for -- if you know the answer to this -- for
a state constitution to proscribe, to prevent the state,
as is the case with the State of New York, from assuming
any financial liability for one of its instrumentalities, that is, a municipality?

Secretary Blumenthal. I simply don't know the answer to that Senator.

Senator Heinz. I don't know of anybody sitting up here who does, but it seems to me that is a rather interesting question, because if the State of New York could assume certain financial obligations, could guarantee, could make guarantees, that might relieve us of the very issue over which we are arguing.

Let let's leave that for some research. I would like to ask you four brief questions, hopefully both my questions will be brief as well as the answers.

First, would you agree that it is the performance of New York City, its ability to balance its budget, its progress toward that goal in 1982, that is really the principal factor in whether or not New York is going to be able to freely enter the financial markets?

Secretary Blumenthal. I would have to say, Senator, it is one of the principal reasons, but not the only one. I think the ability to demonstrate that a credible program for long-term financing has been worked out is as important. I think those are the two critical things.

Senator Heinz. Now let's turn for a moment to the question of seasonal financing. Congressman Stanton has
proposed a seasonal financing bill in the House. Would you agree that with sufficient seasonal financing, that New York City would avoid insolvency, and therefore bankruptcy?

Secretary Blumenthal. With sufficient seasonal financing the City would avoid bankruptcy, yes.

Senator Heinz. Would you agree that with sufficient seasonal financing New York City would be able to maintain approximately the same level of services to the people of New York, and I emphasize the word "services" to the people of New York at the same level as would be contemplated under the loan guarantee program that the Administration has proposed?

Secretary Blumenthal. I think that is a little more difficult to answer, Senator, because depending on how the market judged the availability of seasonal money, and if as a result of no long-term money being available, for example, the MAC would find it increasingly difficult to go to the market for even partial long-term amounts, the maturities would become shorter and shorter, and we would really be back at the kind of problem very soon possibly that we had in 1975.

It is not certain in my judgment that the level of services could be maintained if we had only seasonal financing. It is possible, but it is not certain.

Senator Heinz. You would say it is possible, but it is
difficult to say, it depends on what happens with MAC's ability
to enter the market?

Secretary Blumenthal. Well, I think Mr. Altman makes one
other point, what you could not do is raise the costs
for capital, so you wouldn't maintain the physical plant,
and that in itself has an impact obviously on the services
that you could provide.

Senator Heinz. If you were unable -- first, as I
understand it, the City has been spending an extremely
modest amo-nt on bricks and mortar, $300 million, and even
in '79 or '80 it will not be substantially more than $300
million.

Remember we are talking about a $13 billion budget,
so while it is, I think, possible, as you state, Mr. Secretary,
that you might not be able to do quite as much in bricks
and mortar, and that depends on whether MAC could get in
over the next couple of years without guarantees.

Mr. Rohatyn seemed to indicate this morning he thought
it could, maybe not as much as it wanted, but that it could.

My third question is again with respect to seasonal
financing. Would you agree or disagree with the statement
that with sufficient seasonal financing, New York would
not in any way be encumbered by virtue of seasonal financing
as opposed to the long-term guarantee program of the Admin-
istration from balancing its budget in 1982 as proposed?
That is, encumbered in any significant sense?

Secretary Blumenthal. I think that I would not agree. I think the City would be encumbered from balancing its budget, because it would have very serious refinancing problems as the bonds come due, which it could only meet a very high cost, I presume.

Moreover, I want to make this point, I was not present when Mr. Rohatyn testified, but as I understand it, and no doubt the record will show whether it is accurate, what he said was if they only had seasonal financing, then the most MAC might be able to do -- and he is obviously speculating also, he doesn't know -- would be not four and a half billion, but two and a half billion dollars.

Senator Heinz. That is correct.

Secretary Blumenthal. And cutting that in half would have serious implications. It would require cutbacks.

Senator Heinz. Remember the comparison between $2.5 and $4.5 is not quite fair, because with seasonal financing, you don't need to bond out the $800 million of the State advance, as I understand it.

Secretary Blumenthal. I think you would still have to bond it out. The bonding out is a judgment question that you make. In order to get help from the State, as I understand it, you get that flexibility through the bonding-out.

The point is through bonding out you reduce the seasonal
needs, long-term, and that would be the only way you ever get to a situation where you are on balance, so I think the bonding-out is important, Senator.

Senator Heinz. I am not trying to make a judgment as to whether or not the bonding-out is important. I am merely trying to set the record straight that if you have sufficient seasonal financing, you do not have to go for $4.5 billion. Indeed you go for $3.7 billion. That is the $800 million difference in the bonding-out. It is a simple matter of subtraction.

Now it leaves aside value judgments. All I am saying is the $2.5 billion in terms of the capital budget, or capital needs to be raised by the city, compares to four and a half, it is compared to $3.7 billion if you accept the argument on the $800 million of bonding-out, what is now state seasonal financing.

Secretary Blumenthal. I would have to say if you have lots of seasonal financing, you can finance many of what really are longer-term needs short-term. But that is, I think, a very imprudent way of financing these needs, and it is that kind of thing that got the City into the trouble it is in in the first place.

Senator Heinz. Well, clearly that is the central issue we are trying to reach a judgment on. Of course the four questions I have asked you, to briefly summarize, are will
the performance of the City of New York enable it to get back into the capital market?

Of course if the City can reach the point where it is so healthy, its performance so good, its budget has been balanced, that is the best of all worlds, because the City is standing on its own feet. That is what the City wants to do, and that is what you want to do.

If seasonal financing avoids insolvency and bankruptcy, and I believe you said it did, you know, we don't want to see a draconian solution to New York, we don't want to see New York go bankrupt, we don't know what the consequences of that are.

Then that leaves us with the other questions, can you maintain services under seasonal financing, and your answer was maybe yes and maybe no.

Then we get down to a more difficult question, which is to what extent would seasonal financing make it difficult for New York to balance its budget by 1982, and the answer that you gave me was it will make it difficult for it to borrow long-term, because there wouldn't be any guarantees.

I haven't heard you indicate why it will make it difficult for New York to achieve the balance that is projected in this financial plan.

Secretary Blumenthal. There are two points to be made.
One is that as the maturities get shorter and shorter, the debt service will become greater and greater, and the ability to balance the budget or the possibility of balancing the budget will become harder and harder.

Senator Heinz. This is an important point. Unless I misread your otherwise excellent letter of June 7, this was not a question to which you addressed yourself quantitatively. You referred to qualitatively and said it would be more difficult.

Could you try and quantify this and give us an analysis?

Secretary Blumenthal. We will do that and we will be faster than the last time. I apologize for the great delay.

Senator Heinz. In the letter you blamed it on the City, so I can't blame you.

Secretary Blumenthal. I would have to say that that is a letter written by some of my colleagues, which I approved, but while it is true, everything in the letter is true, but something that is not in the letter, we could have had it to you a little earlier.

Senator Heinz. I would appreciate that if you could supply that analysis, it would be very helpful to myself, and I think other Senators. Thank you, Mr. Chairman.

The Chairman. Senator Riegle.

Senator Riegle. Mr. Chairman, let me just make the observation at the outset to you and to Senator Heinz to my
knowledge this is the first time that three members of the Senate who attended Harvard Business School have been left to their own devices in this Committee or in any other.

The Chairman. They are really in trouble.

Senator Riegle. Not only are they in trouble --

Senator Heinz. I don't know what would happen if we took a vote.

Senator Riegle. We are bound to have three different opinion.

Secretary Blumenthal. The only problem, Senator Riegle, is this is not a case study, this is reality.

Senator Riegle. It seems to me, following the line of questioning Senator Heinz put forward --

The Chairman. Senator, may I ask you to yield for a minute? There is a rollcall now. So I am going to the Floor to vote and I will be back, because I do have a few more questions for the Secretary.

Senator Riegle. I think this is a cloture vote, isn't it?

The Chairman. Yes.

Senator Riegle. In any event, it seems to me the colloquy you were having with Senator Heinz gets down to the nub of where I suspect we are as a Committee now, and that is the difference between continuing the seasonal loan concept versus going to this modified package which would give long-term
loan guarantees. It seems to me that the essential
difference between those two is that it allows, if one's
forecasts and assumptions are right, it would allow the City
of New York to start to refurbish itself, to start to get
money into some capital structure type projects, and start
restoring its own health as a city, and as an economic entity.

It seems to me what we have learned so far, in terms
of the first period of seasonal loan guarantee activity, is
that it was not sufficient to get us to a point where the
City is well enough that it can go into the private market
and raise money.

So while we have made progress in stopping some of
the waste and excesses, we are not to the point where we have
a well City, it is still quite sick, at least financially.

It seems to me at that point it is very important
that we track through what will happen if we were to stay
with the seasonal loan concept. We have done some of that
yesterday and some of it again today. But it seems to me
that not only are the maturities of those roll-overs
of debts, the time periods will get shorter and interest rates
will go up, but I think we will find ourselves in a situation
where we will continue to exhaust the capital resources
of the City. In other words, not being able to start
to reverse those things, I think the City, in an infrastructure
sense, will continue to slide backward.
Then it seems to me that starts to impact the revenues in this four-year financial plan as revised that is presented here. As we look at how we close the gap to get to a breakeven point in 1982, the revenue projections are half of the puzzle. And it seems to me that if these revenue projections are based on the fact that the City is going to start to get better, start to heal itself, and if we find ourselves in a situation where that is not the prospect, and the smart investors and people who can either stay in the City or go elsewhere with their investments are likely to decide to go elsewhere, if the clear message that would come out of a new Federal response was we are not going to help the City get better, we are going to keep it limping along where it is, then we start to impact all kinds of future economic possibilities for the City.

It seems to me that what we do in that case is that we basically decide that it will be crippled in the future. That is what it seems to me the continuation of seasonal loans at this point involves, having to recognize that we are doomed.

I don't know if my friends on the Committee who hold that view would agree with that characterization. But it seems to me that that is the lesson we have learned already. We have been down that road, we found we can't make enough progress to get well enough to get back into the private money
market, as other cities are, so now we have got to adopt this modified approach.

It might be important for us to try to pin down what might happen in terms of these revenue forecasts which we now think are achievable as perhaps not being achievable under those circumstances. If we experience a fall off there I think that becomes a piece of information that people who may be between the issue at this point would want to know about and would want to look at.

The next thing I am concerned with is the commitment from the banks, which I, too, am not satisfied with. I think it is a fairly meager response under the circumstances. I understand the point that they have to respond to their boards of directors and so forth. But nonetheless, I think it is a fairly ungenerous response on their part. The nine conditions that they attach to making available the money they are talking about also disturbs me a great deal.

I am going to have to leave shortly myself to go and vote, and I may have to leave before Senator Proxmire comes back, in which case I would hope everybody would remain in place, because he will be arriving shortly. But I would like to discuss with you, either in person or for the record, I would like to start in person, the nine conditions that they are attaching for coming forward with private sector money, and what are the conditions that trouble you the most.
Secretary Blumenthal. Let me say with regard to the conditions, Senator, that I suspect the banks consider themselves to be in the negotiating process, because the package hasn't been put together yet, and good negotiators, particularly conservative banks, keep their options open. I think there is probably some of that.

But obviously they would have to make good on their commitment and I think they would do so. The trick is going to be to convince them they should increase the amount. I don't think the conditions are going to be as difficult to deal with as the size of the commitment.

Senator Riegle. I guess the problem is where we develop a leverage to produce improvement in their negotiating posture. In other words, it seems to me if this Committee now were to decide to take an action to come forward with a package of some kind, that that removes a good bit of the leverage that presently exists.

So while I might be sympathetic at this point to wanting to find an answer to help solve New York's problem, I would not want to move so quickly that we lose what leverage we have on the private financial institutions.

I am just wondering if you have any advice or thoughts as to how we get that done, short of holding up action here?

Secretary Blumenthal. I think if you were to indicate that legislation authorizing guarantees would be forthcoming
provided an adequate response from the banks and other potential lenders was made, I think that would provide me with sufficient leverage to negotiate a package.

Senator Riegle. Let me just offer the observation, as I have listened to my colleagues speak, and as I have talked to others away from this Committee room, I am convinced in my own mind, as someone who wants to respond to the City's need, that unless the banks are more forthcoming, that we are probably not going to get legislation on this. I am not sure I see the votes here to do it. So I think everybody is going to have to stretch more than they have.

I think the labor settlement the other day was helpful, but I think before we get to a point where we can produce something that will work, everybody is going to have to stretch a good deal more.

Secretary Blumenthal. I agree. And then your analysis earlier on as to the implications on the City's economic position and hence its revenues and hence that plan, under merely seasonal financing, are very well taken. I think we should do more work on it, we will try to specify that for you.

Senator Riegle. The thing I am concerned with here, it seems to me going back and looking at New York's history in terms of how it worked itself into this terrible financial situation, and how it works its way out, which it has been making
in doing it, that we are in a situation now where it is on the road back, but still it seems to be in a sort of downward spiral.

In other words, the City has not really been able to tip the balance in the sense that it is gaining strength measurably.

I guess one of my concerns is whether or not this package is adequate to do that. In other words, whether or not the long-term money involved here, and part of the financing that we will be guaranteeing that will be making itself into infrastructure type things, like the water system and even vehicles that are needed to maintain the streets, and other things, whether or not there is sufficient money in the plan to really do the job with respect to improvement of the infrastructure, so you break that downhill spiral and you start moving things up.

Secretary Blumenthal. I think it is a very tight budget, I think it is adequate to finance the minimum requirements. I gather the people in the City feel so. If you want to make a turn-around, if you want to really have urban recovery, you would have to go further. But that may have to wait a little longer. I think this would tide the City over until that could be done.

Senator Riegle. We really need to understand that, because it seems to me that what happens is it is a very fine line, because at one point I think we are in a position where
we can make the argument that the City is really restoring its health and basic internal strength, and it can become not only creditworthy in its own right, but become a place that attracts people and investment, and it is a renaissance that begins to occur that Mayor Koch spoke about yesterday.

If we fall short of that, it seems to me we are treading water, and this starts to support the rational I heard Senator Heniz making, which says seasonal loans worked before, why not put seasonal loans in place and we can continue to get by.

I want to make sure we have a strong enough case that says that going beyond that, going to loan guarantees, and long-term money, will give us a realistic expectation that we will have sufficient additional resources to plug into the infrastructure that the City starts to get well again.

Secretary Blumenthal. I want to make only one point. One thing we know and that is that seasonal loans have not worked. In fact, we know that seasonal loans have resulted in the City being shut out from the market.

The real question is by extending them for a further period what assurance or confidence we should have that that situation would change.

Senator Riegle. But, you see, that logic might be persuasive to me, but we have to get other votes here. What I am concerned about is the treading water solution may look attractive to other people here, because it avoids the
catastrophe of insolvency and bankruptcy, but it falls far short of the City ever being able to get well again. I want to make sure that we are documenting carefully and fully why the difference between seasonal loans and the package before us that allows enough additional things to happen that it really becomes a smart investment.

I think what you have on the Committee here are people who appreciate the wisdom of dollars being invested that in effect will earn a substantial return. I think the package has that potential but I don't know we have yet been able to articulate that very fully, what the difference is between those two approaches.

I think we have to get that front stage center, because I think that may be what is needed to put together the majority we need here.

Secretary Blumenthal. That is a good thought. We will do that, provide that.

Senator Riegle. I have to leave, so let me recess the Committee until Senator Proxmire returns.

(Short recess)

The Chairman. The Committee will come to order. Mr. Secretary, I just have a few more questions I would like to ask.

In the first place, I think we have overlooked in this situation the economic dimensions of this. People keep asking
if we don't have any assistance, will New York go bankrupt, if we have a seasonal loan, will they be able to work it out, will your program work.

It depends on something that you and I and everybody else would like to be able to do, predict the economic climate two or three years from now. We can't do that. If we have a long recession beginning in 1979 or 1980, then I think you are in real trouble with your plan or with any plan.

I think New York will be in a position where it is in difficulty then, and they will probably have to come back for additional guarantees. And particularly if that recession should hit New York disproportionately.

We don't know whether that will happen or not. We can guess, we can hope, but it is an element here we ought to keep constantly in mind.

We are not dealing with something as sure as a trip to the moon that Senator Schmitt took. That took a lot of calculation, but at least it was subject to arithmatic determination. This isn't. This is something we have to guess and hope and therefore it has that element.

I would like to ask you about the concern that Chairman Magnuson of the Senator Appropriations Committee expressed with regard to the bill. He supports aid for New York, as he did before, he says, but he indicates that he is concerned about making the guarantees subject to the
appropriations process. This was in the Administration bill originally, then it was taken out. Now it is in the House bill in some form.

But it seems to me that the guarantees should be subject to annual appropriations, provided each year, as they are needed, so the Congress can keep an eye on how well the program is going, and whether it is advisable to give further guarantees.

I am talking about a requirement that if you are going to provide guarantees of say $300 million a year, you come to the Appropriations Committee and say that is your intention, that we provide in the law a requirement that you do so, and they approve or disapprove it.

Secretary Blumenthal. Senator, we certainly understand that this should be subject to appropriation. But we really think it needs to be subject to full appropriations at the same time, roughly the same time in which this legislation is authorized, otherwise it would not really be possible for us to work out the kind of four-year commitment for a financing package that is supposed to be getting the City back in the market.

The Chairman. That is a problem, then. It is one thing to have an appropriation that would follow the authorization process, which would be fairly automatic. I serve on both the Appropriations Committee -- in fact, I am the Chairman
of the Subcommittee that handled this in the Appropriations Committee, and the Appropriations Committee doesn't have much choice; the Congress having spoken, we feel pretty much bound to go ahead with the initial appropriations.

You are saying you wouldn't have to come back in 1979, or 1980 or 1981 for the individual approval of the amount of the guarantee, you would want an overall appropriation of the full $2 billion. Is that right?

Secretary Blumenthal. I think the situation really would be the same. I hope the analogy is right, Senator, as it would be with the seasonal financing, where for the last three years the Secretary, providing certain conditions were met, was authorized to operate within those limits.

Here also you would provide in the legislation that the Secretary --

The Chairman. Let me interrupt to say that was a roll-over. This would be an incremental amount.

Secretary Blumenthal. But it was again and again and again. You didn't say each time it is lent you have to come back and let us look at it and see if everything is okay.

The point I am making is you laid down general conditions and you say here is the $2.3 billion, that is your authority, and you can roll it over and lend it, and it was lent by the Secretary a number of times each year.

I think having laid down the strictures under which the
Secretary has to operate, you gave him that discretion. Here in this case, again having laid down in the legislation the strictures, I think it is essential that you allow the Secretary to agree to a plan, which I think is the key, as I have said all along here, for the other lenders to come in. Otherwise we will have an annual situation and the banks and the public and the pension funds really won't know from one year to the next what the Congress is going to do, and therefore won't know if they have a financing program that is secure.

The Chairman. That may be the price you might have to pay. Spell out why that would be so difficult? Say the first year you say $1 billion is the total amount you would be likely to take. You might go to $2 billion, that is in reserve. Say you start off the first year with $300 million that the Appropriations Committee has approved, with the full knowledge they may or may not approve the additional $700 million. Why is that paralyzing or difficult?

Secretary Blumenthal. As the City goes back into the market, wants to go back into the market, as I understand it, as I have learned, Senator, there are two important issues. One, is there a believable budget balancing program that investors will look at.

And, secondly, is there a long-term financing program that makes sense and that is secure.
If it is indeed true, and I know you don't fully accept this yet, but if it is indeed true that for a program to be fully credible, the Federal presence is required for the period, then you wouldn't be able to say it is there for the period, you would say maybe it is there, but it has to go back to the Congress each year.

I think it is that element that would scare away, make it much less likely you could get access to the market, and that is the whole purpose of this exercise.

The Chairman. Well, if that is the price you have to pay for a guarantee, would you still take a guarantee over a seasonal loan?

Secretary Blumenthal. I must say I have never really given any thought to that, it never occurred to me that you might want to do that.

The Chairman. I don't know. Chairman Magnuson made that case pretty emphatically, I thought, and I may have misinterpreted his letter. But it could be that the Congress would decide to do that.

We would like to know your view on that choice.

Secretary Blumenthal. I will give you, as soon as I can, my judgment on that. My first reaction would be that I would very strongly wish to seek to persuade you that that is probably throwing out the baby with the bath water, just as much as the seasonal. I mean the only reason I object to the
seasonal as an alternative is that it may keep the City afloat, keep it out of bankruptcy, but it doesn't lead it back into the market.

The Chairman. We have a specter of acting in 1978 to commit this Government for 19 years, commit the Government up until 1997. The guarantee would apply that long under the legislation, right?

Secretary Blumenthal. Well, I have previously testified, and I want to reiterate again that in the first place I expect that we will be able to negotiate guarantees for a lesser period, not for 15 years. So that the maximum authorization would be --

The Chairman. We have to recognize what we are doing with the legislation, what we are permitting. You would have the authority to do that, go out that long.

Secretary Blumenthal. It would be my intention not to do that, however. I want the record to show that.

Secondly, I think once the City has access to the market, which I expect to happen, or begin to happen slowly but certainly by the fifth year, there are many incentives for the holders of these guaranteed bonds to get out from under them.

I want to mention three principal ones. One of them is that since the unions are involved, as holders of these guarantees, as long as they hold these guaranteed bonds, they
have an Emergency Financial Control Board. And certainly the
unions would like to see that EFCB ended.

Secondly, they get better returns on their portfolio
if they could sell these, some of these, turn them in and make
other investments under normal conditions. I think that is
a second important reason they would want to get out.

The third reason is simply that of diversifying. I
don't really think any trustee has any interest, any
union trustee, to be that concentrated, even with 26 percent,
in a city security, any longer than absolutely necessary.
I mean that would be a stricture on him to do this.

The Chairman. As I pointed out, they were in 60 percent
in city securities in the early '60s.

Secretary Blumenthal. Really, 35 percent.

The Chairman. No, 35 percent in 1975, but they were
in the early '60s far more heavily involved.

Secretary Blumenthal. Oh, but they went on a 15-year
program or something to get out of that precisely for that
reason.

I think if the program works, and this gets back to
Senator Schmitt's question what guarantee do you have that it
will work, and nobody has any guarantees, but if the program
works and the City gets back into the market, it is my full
expectation that the actual period for which these guarantees
will be outstanding will be much shorter.
First of all, we will try to negotiate ten years, not fifteen.

Secondly, there will be a real pressure and real incentive for those guaranteed bonds to be turned in for the reasons I have mentioned.

So I would think seven years is more likely the period than nineteen years.

The Chairman. If the pension funds do sell off their guaranteed bonds, won't this hurt the market for new issues of City bonds?

Secretary Blumenthal. I think if the City has gained access to the market because its financial condition has improved and investors recognize this, and if the pension funds are smart enough to do so gradually, because they have no interest in destroying the market for the securities --

The Chairman. It is still how much paper the market will accept. Of course one of the big customers are the big banks and you have just indicated they like a ratio that is pretty low, low in my view.

Secretary Blumenthal. I think if they were to throw all of those bonds out, that might happen, but I am sure they would not. Their financial advisers would strongly advise them against that.

The Chairman. In making his case for the long-term guarantees, Mr. Rohatyn said this morning the City might only
need $1 billion, and not the $2 billion. However, he said he
wanted the full $2 billion as a safety net.

What do you think, if we were to consider providing
guarantees, could they be cut down to $1 billion or less?
Then if you needed more, you could come back to Congress for
another half billion or for another billion, if necessary, if the Congress approved it?

Secretary Blumenthal. Well, the judgment we have made
is that standby—that is why we called them standby guarantees.
We also hope that they will actually not have to be used
in the full amount. That is I think what Mr. Rohatyn
refers to when he calls it a safety net. It has been our
judgment it is very important to have it available.

I come back to the first point about which I want to
think more, that if at that point the availability were
delimited by a return trip on the part of the Administration to
the Congress asking for that appropriation, you know, it would
be a question about how secure that safety net really is.

It is an iffy one. It is either going to be raised or we have it on the ground, it is either going to be raised
or not, but the decision on whether to raise it is open.
Whereas, if it is there, and can be raised without any question, I think it would make it much easier for the lenders to
provide those funds.

The Chairman. From our standpoint, we are interested,
as I am sure you understand, in doing as little as we can and having the local people do as much as they can. We feel the less we do the more they will do.

The main thing, or a big element, at least, is having some Federal presence, some guarantee, some commitment.

How about the length of the guarantee? I understand that you initially proposed a shorter guarantee. Fifteen years is the present language. Could we cut it down to say ten years instead of fifteen? And what effect would that have?

Secretary Blumenthal. It would just take away considerable flexibility. The best judgment we have had --

The Chairman. What does that mean, take away flexibility?

Secretary Blumenthal. It means it would be more difficult to negotiate a package. The Secretary would have less flexibility in negotiating that package.

There is another point that Mr. Altman makes, that the City's ability to balance its budget is to some extent affected by the length of the bonds that the City can sell, because the debt service is that much easier. To the extent to which the maturities become shorter, there is more debt service, because there is a problem of refinancing emerging.

The Chairman. I wonder if it makes that much difference in balancing its budget. After all, the difference between ten and fifteen years is not that great. I would think that many
members of the Senate would feel you are going out pretty far with fifteen years.

Secretary Blumenthal. With your permission, Mr. Chairman, I would like to think about both of those points and come back and respond to you on them. I don't want to comment off the top of my head as to whether or not that would destroy the program or whether or not it might be possible.

The Chairman. What amount of guarantees and what maturity did you originally recommend to the President?

Secretary Blumenthal. I don't think we recommended anything other than a 15-year guarantee in the original legislation in the House. That is a 15-year guarantee also.

Perhaps what you may be referring to, we have internally considered what might be necessary in the way of a guarantee period, and we concluded that the outside amount necessary we thought was 15 years, we thought we might be able to do it with seven or ten --

The Chairman. You could do it for 7 to 10 years?

Secretary Blumenthal. Yes, and we therefore would ask for 15 years, because it became pretty clear -- there is also another problem which is the length of the bond and the length of the guarantee have to be the same. Originally we thought we might have two different maturities, we might have a 30-year bond with a 10-year guarantee.

It became clear that would be very difficult. We
therefore had to have a guarantee period that was equal to 
the bond period, and that is how we got to 15 years as probably 
the right length for a bond.

I think that is how we got to that number. When we 
were thinking about a 30-year bond and a shorter guarantee, we 
were evaluating whether it would be possible to get away with 
7 or 10 or 12 years.

The Chairman. Would the guaranteed obligations only be 
sold to pension funds, or would they be sold to others?

Secretary Blumenthal. Only to the pension funds. I am 
advised that there is now no --

The Chairman. Why do they need to be taxable then, 
if you sell them only to the pension fund?

Secretary Blumenthal. I think that the philosophical 
problem of having both a Federal guarantee and a tax exemption 
would be --

The Chairman. It doesn't mean anything, does it, 
because the pension funds don't pay taxes anyway. If you 
sell them only to the pension funds and the pension funds are 
not subject to the payment of Federal Income Taxes -- maybe I 
am wrong about that, but that is my assumption.

Secretary Blumenthal. I think it is for that reason, 
because they don't pay taxes, it wouldn't make sense for the 
pension funds to invest in a tax-exempt bond at the 
tax-exempt rates.
The Chairman. Is it a taxable rate? Because it is
geared to the Treasury rate, so it doesn't make that much
difference.

Secretary Blumenthal. That is paid by the City to them.

They get a higher return then.

The Chairman. Well, Mr. Secretary, I want to thank you
very much for another very impressive performance, you
obviously are right on top of this, and we do appreciate it.

I didn't mean to be critical of you, but I think the
whole posture on the part of the Federal Government has been
softer than I think it should be, and I think the prospects
are, under the circumstances, that we are unlikely to have
the kind of rigorous discipline and enforcement that we ought
to have.

As you know, my sentiments are we have done it once
and that is it.

Secretary Blumenthal. I understand, Senator, and may
I say in conclusion that I thank you for the great attention
you have devoted to this matter and for all of the courtesies
you have extended to me over the period, and I am sure you will
in the future.

Secondly, this is a program to which the President is
deeply committed, and which he keeps closely informed on
and considers very important.

And, third and finally, I would urge you in your
consideration of this legislation to really allow us to
provide all of the evidence and all of the considerations that
have led us to the conclusion that little is gained by
going to seasonal as against long-term.

A key element, a key goal, is jeopardized by doing
so.

I said to one of your staff members, to Ms. Bachrach
during the break, that I can understand the position that
they don't need anything else, the banks and the pension funds
can do it on their own. That is clearly an alternative to
providing Federal assistance, and if you feel they can
do it on their own, that is a sensible and easily understood
position.

But once you reach the conclusion, which I hope you
have or will, once you reach the conclusion that Federal
assistance of some kind is required, then the distinction
between seasonal and guarantees, I think, becomes quite a
different matter, and I am concerned that once that decision
is reached, if we do go to seasonal, we will just continue
to limp along and you are going to have the Secretary of the
Treasury in front of you for a long time.

The Chairman. Well, that determination, Mr. Secretary,
does not depend, it seems to me, on the form of the loan,
whether it is seasonal or guaranteed. That will depend on
economic conditions, not what New York can do. That would be
the overwhelming effect, at least. This may have some marginal
effect. But if you have a good economic recovery, if New
York does, as there are some indications it will, it will
recover even better than the rest of the country, no trouble
with either one.

If it doesn't, I think either one is likely to be
in difficulty.

Secretary Blumenthal. That point I fully accept, that the
underlying economic conditions are going to be a very
important factor.

Obviously with a real recession there would be trouble
under any circumstances and with very good economic conditions
it becomes that much easier to solve their problem.

I do think the markets being what they are, it may not
be totally logical, but the chances of gaining access to
the market are immeasurably increased with a guarantee and
conversely, reduced with a continuation of the present
program. That is why I strongly urge in your consideration you
give that every possible consideration.

The Chairman. Thank you very much. The Committee will
stand adjourned until Monday June 12 at 9:30 a.m.

(Thereupon, at 5:45 p.m. the hearing was recessed, to
reconvene at 9:30 a.m. on Monday, June 12, 1978.)