Address by

FELIX G. ROHATYN

Senior Partner, Lazard Freres & Co.
Chairman, Municipal Assistance Corporation
for The City of New York

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New York City is facing a social, political and economic crisis far more serious than the fiscal crisis of the 1970s. This is reflected within the City itself and in the attitudes towards the City in Washington and in the rest of the Country.

Fifteen years ago, in the middle of New York's fiscal crisis, President Ford gave a speech which, even if not correctly quoted, nevertheless was accurately summarized by the Daily News as: "FORD TO CITY: DROP DEAD". We were not dying, and we did not drop dead. We persevered, we recovered and we went on to a decade of unparalleled boom. President Ford did not fare as well as we did; many of us, still now, believe that his remarks, and the Daily News headlines, cost him the State's electoral votes and the Presidential election in 1976.

A few weeks ago, President Bush, in a speech to N.Y. Republicans said that "Life in New York, especially in the City, is becoming more expensive, more difficult and more dangerous than ever before". New York City, he stated, was a "City that lives in fear". The President spoke of "Bad schools, dangerous streets, big deficits, open-air drug markets and muggings". Even though Senator Pat Moynihan suggested that only Red China and Albania deserved these types of Presidential descriptions, the sad truth is that
George Bush's description is, unfortunately, only too close to the truth. Blaming the situation on liberal politicians was a simple political attack; a decade of neglect of urban problems by the Administrations of Presidents Reagan and Bush helped bring this situation about. But the description was accurate; not only was it accurate, but the perception of the City is worse than the reality, not only in the United States, but also abroad.

In viewing the statements of these two Presidents, and to the reactions thereto, we can find some of the main differences between the fiscal crisis of 1975 and the far deeper crisis the City is facing at the present time.

The reaction to Ford's statement was violent. The New York press attacked him relentlessly; the business/labor coalition, functioning very effectively at the time, lobbied Washington furiously; so did a political coalition of Northeastern states spearheaded by New York; President Giscard d'Estaing of France and Chancellor Helmut Schmidt of West Germany personally urged President Ford to provide Federal credit support to the City. Finally, although grudgingly, the President and the Congress decided that it was better to help New York City than to bury it; this decision was, to a large extent, facilitated by what New
York was doing to help itself. New York State put its credit behind the City's; New York's labor leadership agreed to far-reaching concessions; the New York City banks, many of them with a significant part of their capital at stake, participated in major financial restructurings; a new City administration, assisted by the EFCB and MAC, brought the City back to financial equilibrium. The City both helped and benefitted from the financial boom of the early eighties. The City responded to strong political leadership; despite the many problems endemic to all large urban centers, the City appeared to be manageable; despite the departure of a number of businesses in the 70s, the spirit of the City was decidedly upbeat. New Yorkers were proud of their City, warts and all; we felt that we had waged, against very long odds, a political battle for the future of the City and that we had won.

The reaction to Bush's statement, on the other hand, was quite muted. Apart from Moynihan's response and a statement by Congressman Charles Rangel, it was ignored by the New York political leadership and the press. This was partly due to the fact that Bush's statement was not nearly as threatening to the life of the City as was Ford's. It is also, however, due to the fact that the City today is vastly different from the City of 1975. There is no effectively structured business/labor cooperation that can affect the
City's basic problems. There is no strategic City/State political alliance that deals with the City's agenda in Albany or in Washington. There is no crusade about the City's future. There is a feeling of helplessness about the City's long-term problems.

Looking realistically at the City's problems today is a risky business. The press is regularly criticized for allegedly overreporting on crime, homelessness, racism, drugs as if ignoring the truth about what is happening in the City would somehow make it all go away. Some of it is overdone, unfair and very damaging to the City; in particular the Time's cover story on New York City. However, the high profile of violent crime in the press over the past several months has served to focus public attention on spreading patterns of danger and desperation that are leaving no section of the City untouched. This may set the stage for a really effective program to recapture the streets and the subways from the criminals and to get legislative action to provide for stiffer criminal penalties.

New York City, during the fiscal crisis, could well be described as a "gorgeous mosaic". Mosaics are held together by some type of adhesive, some bonding material that keeps them from falling apart. There was a bond then, about the future of the City and the hope that it could provide
opportunity for its citizens. Today, New York has become a city where despair and fear, anger and violence turn ethnic groups against ethnic groups, races against races, classes against classes. The quality of life is the dominant economic, social and political issue facing the City today. That quality, for black or white, hispanic or oriental, rich or poor, is unacceptable and getting worse. The fact that other cities may be worse off is not really relevant. New York has to judge itself against higher standards. The many wonderful aspects about life in the City, the intellectual stimulation, the cultural mix, the driving energies are being buried by the grinding pressures of the problems. The streets that are not safe; the public places that are not clean; the schools that are deficient and the drugs that are rampant. I love New York and cannot imagine leaving the City, but many other people and businesses are thinking of leaving. The future of the City depends on its ability to reverse these trends, and to convince New Yorkers and out-of-town visitors that a change is taking place.

There are, of course, a great many explanations, all of which have a degree of validity, to explain the plight of the City. These include the failures of the Federal government to support urban programs, to fight drugs, to fight crime, to provide assistance to housing, public transportation, and so on. Had federal urban programs
remained at 1981 levels, New York City would have received an additional $2.4 billion of budget support in FY1991. They include the inability of the State to provide greater levels of support, especially in the field of public education, to socially disadvantaged urban areas. However, the fact that we must maintain a steady political pressure on the Federal and State governments to help with many of our problems does not provide the City with the luxury of simply accepting the status quo. Change in Federal spending priorities is a must; but that will take time and require a drastic political realignment. In public life, the status quo does not exist; things get better or they get worse. In New York, right now they are getting worse. In order for things to get better, the City will have to make some fundamental, possibly revolutionary, changes in the way it goes about its business.

There are many myths today which inhibit change and which encourage the acceptance of the unacceptable. One of the most pervasive is the myth of the lack of means. It is not the will of God which creates the problems of the City; it is also not only the lack of money. A city with a budget of $29 billion, a payroll of $15 billion, a workforce of over 300,000 people and a capital program of $5 billion per annum is not exactly without resources. The last ten years have seen the workforce of the City grow dramatically, by
over 50,000 people; at the same time, labor contracts grew generously in terms of compensation and benefits. This is not the profile of a city without means, even though the needs to be met are also considerable. And yet despite the significant increase in the size of the workforce and in their compensation, the services delivered to New Yorkers and the quality of life in the City have steadily degraded. It may be that the time has come to question the City's overall wage-and-personnel policy which appears to be: continued increases in the number of employees; across-the-board increases in compensation; little or no real increase in productivity. A test of the City's willingness to challenge past practices occurs in this year's labor negotiations.

The City's 1991 budget deficit of $1.3 billion was closed with almost $900 million in new taxes, almost $300 million in MAC surplus funds and the balance in various types of savings. These actions cannot be repeated forever. It is already becoming clear, in view of the sharp deterioration in the City's economy, that another budget gap of considerable proportions is looming. It could be well in excess of $1 billion or even $1.5 billion without any increase in labor costs. How these future deficits are dealt with will be this Administration's main challenge.
The City must develop an overall economic and management philosophy in setting wage and personnel policies. Failure to do so, in the presently highly uncertain economic environment, could result in a roller-coaster of layoffs and service cuts damaging both the City and its employees. To begin with, the City's 1.5% labor increase, included in this year's budget, is more than the City can afford and probably less than the unions can settle for. The City could not find the $30-50 million required to hire 1,000 additional policemen and had to finance these additions by piecemeal cutbacks in everything from education to libraries. With the City's economy in a recession, and the national economy about to go into one, the right approach would call for a one-year freeze in total labor costs, which could accommodate different types of individual settlements, while a clearer picture about the economic outlook is afforded, and while the City negotiates a different wage-and-personnel policy with its unions.

Nothing would be more destructive to the City's economy than an across-the-board labor settlement, at rates the City cannot afford, followed by widespread layoffs 6 months or a year from now, or financed by further tax increases which will drive more people out of town. A recent report by the Citizen's Budget Commission made some useful suggestions in that regard. It recommended that the City should establish priorities among its working force and allocate its
resources accordingly. Thus, if crime control and public safety are to be the City's first priority then the City, instead of hiring 1,000 policemen now and probably more later, should decide just how many policemen are really needed to do the job. That figure may turn out to be 5,000, or it may be more. However much it is, those policemen should be hired and the funds taken away from lower priority functions, such as clerical functions. This can be accomplished either by freezing the salaries of less essential workers or by the early retirement of some City workers or by layoffs, or a combination of some or all of these. During the fiscal crisis of the 1970s, the City froze new hires and allowed an 8% rate of attrition to reduce the size of the workforce without layoffs. Such an attrition rate would reduce the size of the present workforce by about 25,000 people for a savings of about $750 million per annum. This step might be considered selectively at the present time with exclusions for policemen and teachers. Reducing the size of the workforce need not result in loss of services; that is the job that management is called upon to perform.

Similarly, public education deserves an equally high priority. If the City needs to increase teacher salaries to be competitive with other districts and to maintain what vitality is left in our public schools, then Chancellor
Fernandez should be asked to reduce as drastically as possible the bureaucracy at 110 Livingston Street and the budgets of the local school boards. It is hard to believe that deeper cuts cannot be made in the bureaucracy without in any way reducing what goes to the students. To the extent that is not sufficient, other lower priority City functions should be cut. It is tempting to say: "Increase taxes to pay for cops". Everyone wants cops. But then why not increase taxes to pay for teachers? Everyone wants teachers. But we have just had a $900 million tax increase and, in New York today, every form of human activity is taxed to the hilt, with the possible exception of trips to the bathroom. And we are facing billion-dollar plus budget gaps without the resources to deal with them. In addition, in the present economic climate, the City's credit ratings have to be protected since ample market access must be maintained to enable the City to finance its ambitious infrastructure investment programs. Before the City adds to its tax burden, New Yorkers will have to be given a credible long-term plan about the City's economy and the structure of its services which should include both potential revenue measures as well as plans for expenditure reductions.

Radical change is needed in public education in general. The right to a decent public education should be legislated as one of this Country's basic civil rights.
Decent public education does not mean somehow getting a high school diploma. It means performing well enough in high school to get to college and then to graduate from college, intellectually equipped to compete for tomorrow's jobs. This is a necessity if the City's economy is to have a future. It is light years away from today's reality.

The backbone of the City's economy are the service-related industries: financial; communications; media; entertainment; etc. Modern technology makes it easy for many of these industries to move, not only to New Jersey, but to Denver, London or Singapore. These industries require skilled, educated, high-school and college graduates; they will pay them well. But, if they are not available, the industries will have to move.

Enough has been said and written about the City public school system to fill many of our presently-closed libraries. But again, money is not the only problem. Certainly we should get a fairer share of the State's public school allocation formula. But we do spend $6.5 billion, or $6500 per child per annum for a system whose results are truly dismal. We know that the drop-out rate is about 40%; we do not know the real level of literacy and skills of those who get a high school diploma; we do not know how many finally matriculate from a college or university or how many
drop out during that process; we do not know the level of skills of those who do matriculate. But we do know that New York City banks or telecommunications companies have to interview literally thousands of applicants to fill a few hundred clerical jobs. That is not good enough for today, much less tomorrow.

We have the good fortune to have an outstanding Chancellor in the person of Joseph Fernandez, but one outstanding man, no matter how energetic, needs a great deal of help and a great deal of time if he is to tame this bureaucracy and fundamentally change the system. He may not have either. It took two years to get rid of the Board of Examiners; it took two years to begin to crack the absurd practice of tenuring a principal to a particular school building; it took two years to create a separate agency for school construction and provide an exemption from the Wicks law. How long will it take for the Chancellor to establish some control over the local school boards and how long will he have to fight in court to obtain a veto over the appointment of district superintendents? How long will it take to recapture the school buildings from the grip of the Custodians Union? Will the Board of Education ever be accountable to the Mayor or to any public official for that matter? The answer to these and many other similar questions is: Too long or never.
I am perfectly aware of the fact that New York's public school children have special problems. That there is a need for early intervention, tutoring, counseling, evening and summer sessions, educational assistance for parents, etc. I also know that these things cost money and that additional funds may be necessary. But it may be time to concede that the existing structure, practically speaking, is likely to fail and that additional funds might not be effective. A drastic, radical restructuring of our public school system may be our only option.

In Minnesota, in Wisconsin, in Oregon, various initiatives to make the schools accountable by giving parents a real choice of schools for their children are being tried or discussed. Some of these include state-funding to allow public school children to switch to private or parochial schools. These may not, in every way, be appropriate for New York. However, I believe that we should try to devise a system allowing "choice" under state supervision and control which would answer our needs. This means that it must protect our poor and less achieving students. I am aware of the fact that there is a choice of programs available to high school students. A choice of programs is insufficient; there should be a competitive choice of schools. Such a system, as Wisconsin and Minnesota are experimenting with, would provide State & City funding to new schools for every student enrolled. It would
allow the schools to control their destiny by hiring their principals and teachers and determining their curriculum, somewhat along the lines of Chancellor Fernandez's school-based-management program, but it would add the element of accountability: schools which could not attract enough students would cease to exist. This might ultimately eliminate the need for much of the bureaucracy at 110 Livingston Street. It would also encourage the use of modern technology in schools. The use of computer assistance, VCR's, video and other technology is woefully absent from our schools. A new system could bring this about. Providing parents with the wherewithal to make educated choices, providing transportation for students, and many other important details and functions would be provided by the City or the State. The idea that inner-city parents are incapable or uninterested in making intelligent choices on behalf of their children is absurd: given the opportunity, they will be involved and they will be capable.

The existing system must be reformed radically or another system must replace it. The alternatives of "choice" should be pursued vigorously in Albany as well as in New York. A new system, at almost any price, is preferable to what we have today.

Last, but not least, there is a need for a long term, economic strategy for the City. Money created the boom of the eighties. Money and jobs were created by the financial
services industry and the rise in the markets. Money and jobs were created by the real estate boom and the rise in real estate values. The business of the City revolved around the catering to wealth and some of that ended with the crash of 1987. This activity is under even greater pressure today, first as a result of a regional recession; second, as a result of the turmoil in the economy caused by the situation in the Persian Gulf. It is critical for New York City to remain the financial capital of the world. Many things are conspiring against it. Modern communications technology allows for many of these activities to be moved to remote sites. The power of Tokyo's and Europe's financial institutions creates gravitational pulls away from the City that will become more intense. Suggestions such as the imposition of a securities transfer tax add to these outward pressures. The recent power failures downtown have frightened many market makers. And the inability to find skilled employees locally as well as a greater and greater reluctance for outsiders to move to the City is becoming a serious problem. A special working group should be set up by the Mayor to develop and implement an ongoing plan to maintain and support the growth of the financial service industry in New York City.

The City should also aspire to become the tourist capital of the world. New York has more entertainment, sports, and cultural assets than any other city in the
world. It is the media capital of the world. It has great universities. Its surrounding areas, the Long Island beaches, the Upstate mountains and forests are enormous tourist attractions. The cheap dollar should make this strategy even more attractive. The City should be an attraction both to Americans and to foreigners. However, to adopt such a policy successfully, the City will have to do a number of things. It will have to demonstrate that it is safe. It will have to clean up the Theater district. It will have to provide skilled employees and management to the hotels and other tourist establishments of the City. It will have to provide decent public and private transport. The City administration scored a political coup in getting the 1992 Democratic Convention to come to New York. It will take more than political muscle, however, to make the City fit to receive the Convention and make the City, in general, hospitable to visitors from inside and outside the U.S. That will require a coordinated strategy. As in the case of financial services, a special targeted task force should be set up by the Mayor for this purpose.

One commitment we must all make is to the restoration of public safety and public decency, and to the rebuilding of our self-respect as individuals and as a community. For a period so long as to shame us all, outrageous criminal violence has been allowed to rampage virtually unchecked,
destroying many thousands of lives and many of our best hopes. It has torn us apart from each other, and threatened to make each of us a stranger isolate and alone.

To reestablish public safety and decency requires an indispensable first step: that we rebuild the strength, the force and the effectiveness of the police. Therefore I have chosen to join Commissioner Lee Brown, and many other leaders of business, politics, law, education and law enforcement, from all sections of the Country and all shades of opinion, in the effort to create the Police Corps. The Police Corps would augment our undermanned police forces with the service of our best young people, of all races and classes. These young people would receive four-year college scholarships, in return for which they would serve four years in their local Police Department after graduation. Like the ROTC and the GI Bill, the Police Corps would induce and reward the service of young people during a national emergency. It would attract the energies and intelligence of our youth to our most pressing problem. And it would allow us to pay for a vital government service without the pension expense that so burdens municipal public finance.

New York City is rapidly nearing a crossroads. One road leads to continued degradation in the quality of our life, increasing racial and social tensions, the flight of
businesses and families financially able to move. The other road leads to recovery and the maintenance, into the 21st Century, of the City as the financial and cultural capital of the world. It is a difficult road and it will require inspired political leadership, sophisticated management and a commitment to a real partnership between government, business and labor which we have not had since the 1970s. The City faced similar alternatives a decade ago and was able to take the road to recovery. It is the only road to follow. Mayor David Dinkins and his Administration, with the support of Governor Cuomo and the State Legislature, must assume the leadership and the responsibility for saving New York City.

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Testimony by
FELIX G. ROHATYN
Partner, Lazard Freres & Co.
Chairman, Municipal Assistance Corporation
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THE UNITED STATES SENATE
Committee on Banking, Housing and Urban Affairs
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Mr. Chairman, members of the Committee:

I welcome the opportunity of appearing before your Committee. My name is Felix Rohatyn and I am a senior partner in the investment banking house of Lazard Freres, where I started my career thirty-seven years ago. My work consists mainly of advising corporate clients as to financial matters in general, and mergers and acquisitions specifically. I was a governor of the New York Stock Exchange from 1968 to 1972, and the Chairman of its so-called "Crisis Committee" during those troubled years. I serve on the Board of Directors of several large New York Stock Exchange - listed corporations and as Chairman of the Municipal Assistance Corporation for the City of New York.

Almost two years ago, I testified to your Subcommittee on Securities about some of the issues you will be examining during the coming months. The concern I expressed to you then has unfortunately turned out to understate the facts. As the revelations of illegality and excesses in the financial community begin to be exposed, we, in the financial community, have to face a hard truth: there is a cancer threatening our industry. How far this cancer has spread will only become clear as the SEC and Federal prosecutors bring forth the various investigations currently under way, but it has obviously spread considerably. The cancer is called greed.

It is driven by a general climate of speculation we have not seen since the 1920s; it is not totally unrelated to our continued, huge fiscal deficits; it is encouraged by deregulation and market ideology; it is specifically focused on the recent wave of huge junk-bond financed takeovers and on the various activities related to them. Its most deeply disturbing aspect, so far, has been the Boesky affair.

Before discussing some of the specific issues we will be dealing with here, it is worth noting a relatively new phenomenon. The Stock Market is at an all-time high and booming while business is relatively slow and major sectors of our economy are in serious difficulty. Furthermore, looking to the future, aside from the dollar devaluation, which is a double-edged sword, we see little or no evidence
of a realistic willingness to solve our most fundamental economic problems: our budget deficit, our trade deficit and the vulnerability of our banking system. The financial markets now have a life of their own, seemingly unrelated to many underlying economic realities. The need for productive investment in this country, together with the risks created by the level of existing speculation, make it more important than ever that the integrity of the markets be assured and that capital be used to build and not to speculate. This is the framework in which the current issues should be considered.

The questions raised by recent events should be examined in two contexts:

1) Illegal activity and the adequacy of existing laws and regulation to deal with it;
2) The implications to the economy of the present level of takeover activity, with specific focus on potentially dangerous levels of leverage.

With respect to the former, I will leave it to other witnesses to comment on enforcement and the possible need for other tools to catch wrongdoers. However, there is obviously a broader issue involved here, namely that of the ethics of a profession where integrity has to be fundamental. After all, the word "credit" comes from the Latin meaning "to believe"; belief in the integrity of our financial system is certainly open to question at this time.

The explosive growth in financial services, and the huge rewards related thereto, have caused obvious strains on the ability to maintain relatively old-fashioned standards and traditions while adjusting to the pressures of the new deregulated environment and the technologies which allow endless development of new products. Investment banking firms, law firms, arbitrage firms, investment advisers, etc., have grown often tenfold in personnel over the last few years. In most cases, much of the growth has been accomplished by hiring young college graduates, MBAs or law students and having them involved in high pressure, high profile and extremely sensitive activities such as mergers, large block trading and arbitrage.

An industry which traditionally provided independent financial advice and distributed securities on behalf of its clients has turned into a business creating and selling new products and relying more and more on the trading of securities for its own account to generate profits. Long-term relationships are no longer valued; it is the age of the financial samurai. The same is true of many law firms. And the behavior of financial institutions is mostly geared to short-term results. The fact that this is as much the fault of the clients as of the lawyers or bankers is beside the point; the result is what counts. Too much money
is coming together with too many young people, with little or no institutional memory for tradition, under enormous pressures to perform and under the glare of Hollywood-like publicity. It is a recipe for speculative excesses at best, illegality at worst. Insider trading is one manifestation of this cancer. No firm, even my own, is immune from it, no matter how carefully it handles sensitive information. We have to rely on the ethics and the character of our people; no system yet invented will provide complete assurance.

It is against this background that we should look at the present situation from the point of view of the public interest. It is also important to remember that merger and takeover activities include not only investment bankers, raiders and arbitrageurs. Lawyers, commercial banks, and maybe most importantly, large institutional investors, all play an important role. Furthermore, these activities have become international in scope, with emphasis on the London market.

The issues involved here are three-fold:

a) The integrity of our securities markets;
b) The safety of our financial institutions;
c) The constructive use of capital as an engine for growth.

These are all jeopardized by what is happening today.

Over the long run, the capital markets self-correct, but sometimes abuses become so widespread that the markets must be helped by legislation or regulation. Today that is the case in respect to takeovers. The abuses fall into several general categories:

a) Unequal treatment of shareholders as part of offensive or defensive corporate actions;
b) Unsound financial structures as a result of excessive leverage;
c) Destabilizing impact of large scale arbitrage and other short-term trading activities as an integral part of mergers and takeovers.

I would like to examine each of these briefly.

a) The basic concept of our securities laws has been full disclosure, non manipulation, and equal treatment of all shareholders. Both the techniques of current takeovers as well as current legal trends undercut these concepts.

In tender offers, two-tier takeover bids heavily favor professional traders to the detriment of non-professionals. Bids that are made "subject to financing", in many cases directly or indirectly financed by junk bonds, permit the bidder to manipulate the markets without committing himself to purchase. The resulting activity by arbitrageurs and
short-term traders create speculative accumulations which, in the parlance of the trade, "put the company into play". Whether the outcome is "greenmail" or a "white knight" rescue, the result is a large profit for the raider, at minimal risk.

Because of these tactics, defensive maneuvers have been devised that are equally objectionable to shareholders. The payment of "greenmail" is the most obvious and, in many ways, the most old-fashioned of these maneuvers. Selective repurchase of stock, "lock-ups", "crown jewel options", "shark repellent" and "poison pills" of one kind or another, all have been designed to enable managements and boards of directors to interpose themselves between the shareholders and takeover bids. State takeover statutes giving management and directors almost unlimited licence to entrench themselves are becoming more frequent. These can be used against bona fide bidders as well as against the more pernicious types.

The most basic elements of stock ownership, i.e., equal voting rights and equal equity ownership for all common shareholders are now under attack. For instance, the NYSE has allowed the listing of common shares with unequal voting rights; and recent decisions in Delaware permit, in certain cases, unequal payment among common shareholders.

b) As a result of this activity, financial structures are seriously eroded. In recent years, some of the largest takeovers were brought about as a result of raids, financed by junk bonds, on the target companies. Most of these were then acquired by third parties. A large part of the oil industry has been reorganized as a result. The mergers of Chevron-Gulf, Occidental-Cities Service, Mobil-Superior all occurred as a result of raids or the threat of raids. The deterioration in their combined balance sheets has been dramatic. Far from being a healthy restructuring, the oil companies involved are cutting exploration sharply, a practice our country will pay for dearly when the next energy crisis occurs. With their high levels of debt, they could be in serious difficulty if the price of oil declines again. If one were to write a scenario about how to get the U.S. into trouble as far as energy is concerned, it would be hard to improve on what has happened.

It is in the area of large takeovers that the junk-bond phenomenon is particularly hazardous. High-yield, low-rated debt, in reasonable amounts, is a perfectly acceptable financing vehicle for many companies ineligible for investment-grade credit ratings. It is a different story, however, when this type of debt, in the billions of dollars, is used to substitute for equity in the takeovers of very large companies.
The risk in this type of operation is twofold. First, in the actual security of the paper. If the takeover is successful, the servicing of very high levels of debt, at rates of interest in excess of most targets return-on investment, requires significant asset dispositions which may not always be possible or desirable. It is an approach that also completely fails to take into account the fact that a large corporation is an entity with responsibilities to employees, customers and communities, which cannot always be torn apart like an erector set. The alternative to a breakup requires significantly improved cash flow performance. This requires cutbacks in R&D, capital-spending, and usually, significant reductions in employment. It may cause some companies to be leaner and more competitive; It may also require sacrificing the future.

The second element of risk in this type of paper is liquidity. Even though much of this paper is sold to financial institutions such as savings banks, insurance companies and pension funds, in many instances, no large scale, liquid public market exists in these securities and purchases and sales are handled through private transactions. It should be noted that many of the investing institutions are in financial sectors under considerable pressure at this time.

To protect themselves against this type of takeovers, companies have begun large scale restructurings of their own whereby they assume significant amounts of additional debt in order to shrink their equity and increase the price of their stocks. FMC, Colt Industries, Owens-Corning Fiberglass, Gillette and Goodyear are the most recent example of this trend. In addition, Goodyear and Gillette paid vast amounts of "greenmail". Excessive debt to equity ratios are the result. Whether in the long run, this is sound financial policy and good for the Country is open to question. It is obvious that these restructurings are driven more by the fear of takeovers than by straightforward economic forces.

Junk bonds, of course, are not the only source of excessive leverage in recent takeover activity. Large scale leveraged buyouts and "going private" transactions have been financed by bank and institutional loans as well as by junk bonds. They have to be judged on a case-by-case basis. In many cases, some simplification of corporate structures may be quite appropriate and no junk bond financing is involved. But, the result, in most cases, is more and more substitution of debt for equity and less and less stable financial structures.

c) Added to this combination of unequal treatment of shareholders and unsound financial structures is the market
speculation which has become an integral part of the process. Very large pools of money are managed by arbitrageurs looking for rapid returns; some of these pools are financed by junk bonds. Equally large pools of money are in the hands of raiders, similarly financed. This creates a potentially interlocking set of relationships which has as its basic purpose the destabilization of a large corporation and its subsequent sale or breakup. It creates, at the very least, the appearance, if not the reality, of professional traders with inside information, in collaboration with raiders and junk bond buyers, deliberately driving companies to merge or liquidate.

Another important and related factor is the behavior of institutional investors. Between $75 and $100 billion of junk bonds have been placed over the last five or six years. Probably half this amount has been directly related to takeovers, leveraged buy-outs and restructurings. Only financial institutions can provide purchasing power in such size. The cornerstone of junk bond takeovers is the willingness of financial institutions, fiduciaries for depositors, retirees and policy-holders, to acquire this paper in vast amounts. Insurance companies, savings-and-loans, pension funds, commercial banks, all want to show short-term performance with high-yielding assets; so far, the experiment has been a success. Interest rates have declined steadily over the last five years and the stock market has boomed. What happens in a downturn is a different issue, especially if that downturn is accompanied by rising interest rates as a result of foreign capital flight. There are several financial time bombs ticking in our closet; this is potentially one of the largest and most dangerous.

In summary, what does all this add up to?

1) At a time when we are trying to encourage long-term investment, this activity encourages speculation and short-term trading;

2) At a time when we are trying to strengthen our important industries to make them more competitive, this activity weakens many of our companies by stripping away their equity and replacing it with high-cost debt. Leverage can promote growth when borrowed funds are used to make new investments to meet future market needs and be more competitive. It is quite another story when leverage is created to pay out shareholders today at the expense of growth tomorrow.

3) At a time when our financial institutions (banks, savings banks, insurance companies) are under considerable pressure, this activity preempts more and more general credit and causes the weakest sectors to acquire large amounts of risky and possibly illiquid paper to show performance. Much of this paper has never been tested in a period of economic downturn.
4) At a time when we need to continue attracting capital from all over the world, our securities markets appear to be more and more under the control of professionals and insiders.

I believe that these issues are sufficiently serious to warrant the relevant regulatory authorities and the Congress to consider more stringent regulation coupled with new legislation.

Some or all of the following areas should be studied:

1) **Junk Bonds**
   a) Limit the amount of below-investment grade paper, which can be carried by federally and state-insured institutions;
   b) Require a higher standard of care and prudence from directors, officers or trustees investing in this type of paper, if they are to be protected by indemnification provisions under their charter or by-laws; make it clear that achieving the highest short-term investment returns is not the main fiduciary obligation.
   c) Limit the tax deductibility of interest by highly leveraged companies which have acquired significant amounts of their own, or another company's stock or assets;
   d) Review whether "disclosure" is a sufficient standard to qualify securities for registration under the Securities Act.

2) **Takeovers and Tender Offers**
   a) Require 100% financing commitments before allowing a tender offer to commence;
   b) Lengthen the tender offer period to 60 days;
   c) Require a one-price, 100% offer for any buyer wishing to acquire more than 20% of another company.

3) **Financial Institutions**

Consider a tax on the profits on securities transactions of presently tax-free institutions in inverse proportion to their holding period.

4) **Arbitrage, Hedge Funds, etc.**

Consider limiting the right to vote on major corporate matters such as mergers or restructurings, to shareholders with a minimum holding period, say one year.

At the same time, if takeover excesses are curbed, abusive defensive tactics must also be curbed. Not all takeovers are bad, not all managements are good, not all directors represent the shareholders best interests. Takeovers do not have to be friendly; they have to be fair and soundly financed. The following should be considered:
1) Outlaw all forms of "greenmail";
2) Re-establish the principle of "one share - one vote";
3) Eliminate any form of "poison pill".
4) Require shareholder vote on any bona-fide offer for 100% of a company, or on major restructuring proposals;
5) Eliminate "crown jewel options", "shark repellents", and all other defensive strategems designed to discourage a bona-fide bidder;
6) Override state takeover statutes which provide management and directors with almost unlimited license to turn away bona-fide bidders and entrench themselves.

I am obviously not suggesting that all of these should be adopted, but they are all elements of the various issues involved here. The objective of any legislative or regulatory approach should be to create a level playing field as to bidders and targets, and return as many major corporate decisions into the hands of investment-oriented shareholders.

I have been an investment banker for more than thirty years. It has been an honorable profession; I want it to stay this way. I have negotiated hundreds of mergers and acquisitions for a variety of corporate clients. Most of these were the result of negotiated agreements; some were bitterly contested, hostile takeovers. All of them were properly financed. I hope to continue this activity for many more years. It is an integral part of the service an investment banker should provide his clients and it is an important factor in maintaining a competitive market place. There is no question in my mind that thoughtfully negotiated mergers have a better chance of achieving their objectives than multi-billion dollar takeovers, or major restructurings, decided upon over a weekend, as a result of a raid. Nonetheless, there should be room for many types of transactions in our market system, but very clear lines should be drawn between what is acceptable economic and corporate behavior on the one hand, and what is runaway speculation on the other. That is not the case today.

There are always arguments against any changes. The political power of the junk bond lobby was in evidence last year when Federal Reserve Board Chairman Paul Volcker barely won the right to effect a minor change in the margin rules against fierce opposition. Both in the Senate and the House, arguments for legislative change were brushed aside. However, the integrity of our securities markets and the soundness of our financial institutions are vital national assets. They are being eroded today.

The picture of greed and corruption presently in the headlines could unleash a vicious backlash against financial
institutions as well as individuals. Individuals who break the law must be punished; institutions should be reformed. The securities industry is, and has been, heavily regulated since the 1930s. It has operated successfully and comfortably in a highly regulated environment. The notion that additional legislation would interfere with the operation of a totally free market is a complete myth in this particular case.

I believe that as a result of the ongoing revelations of scandals, the securities industry will have to accept new legislation and regulation to curb the speculative abuses of the past several years. This is long overdue. Instead of trying to fight against the inevitable, I hope that financial industry leaders will cooperate with the Congress in the coming legislative hearings to help shape rational laws and rules to reform the system. If they do, our financial market system will emerge stronger and cleaner from its inevitable torment; if they do not, the resulting legislation may be so punitive as to result in detriment to all.

* * *


Address by

FELIX G. ROHATYN

Chairman,

MUNICIPAL ASSISTANCE CORPORATION
for the City of New York

Before

THE CITY CLUB OF NEW YORK

New York City

November 22, 1985

Not for release before November 22, 1985
New York has just reelected her Mayor to his third term; we are in the sixth year of consecutively balanced budgets; the City's fiscal crisis is ten years behind us. As we look at the City's agenda for the next four years, at both our problems and opportunities, we must note a fundamental change in our situation today and the situation a decade ago. If I were to summarize my views of New York City in November 1975, it would be: "We have found the enemy, and it is us." Today, I would say, without the shadow of a doubt: "We have found the enemy, and it is in Washington". This is not meant to denigrate the immense problem areas we must face here: housing, education, mass transit, etc. But I believe, and I will revert to this later, that New York City and New York State are quite capable of meeting those challenges, given our present financial and economic strength, if we were not subject to the enormous risks created by our national economic policies.

There is no simpler way to compare the effectiveness of political leadership in the face of real problems than to compare New York's response to our fiscal crisis in 1975 to Washington's response to a national fiscal crisis in 1985. When faced with a runaway deficit and a real default crisis in 1975, New York's political leadership took real actions. Budgets were cut, taxes were raised, expenditures were
frozen, the debt was restructured, fares were increased, tuition imposed. A real crisis was faced with real actions and the rest is history. The credit belongs to all involved, Republicans and Democrats, business and labor.

We were told, in 1981, that a new approach to the management of our national financial affairs, supply-side economics, would balance the federal budget, stimulate investment, and encourage savings. Four years later, we have the biggest deficit in our history, our national debt has doubled and we have the lowest rate of savings since World War II. Our economic growth has been fueled by borrowing, principally abroad, with a resulting highly overvalued dollar and huge losses to American industry and agriculture. Fundamental to every one of these issues is the Federal deficit.

Senator Proxmire, formerly our toughest critic, recently stated, most graciously, that Washington might follow New York's example in solving our fiscal problems. Washington, today faced with a runaway deficit, is meeting its challenge with Alice-in-Wonderland solutions. A fake default crisis is being orchestrated in order to promote a fake budget balancing bill. Everyone knows the Federal Government will not default on its obligations just as everyone knows the Gramm-Rudman bill is not a responsible
answer to the budget problem. In addition to this fake solution to a fake crisis, we are asked to believe that fake tax reform will solve any remaining problems of growth or equity. In the meantime, the real crisis, i.e., the runaway deficit and the growth in the national debt, is left untended. All of this would be amusing if it were not so dangerous. Just as in New York's crisis the credit for success belonged to everyone involved, so the blame for the Nation's financial crisis will also belong to all who were involved.

The risks to New York will come from specific Federal actions (deep budget cuts in vital service areas, challenge to the deductibility of state and local taxes, etc.) and the possibility of a serious national economic downturn as a result of overall Federal inaction. A nationwide recession, starting with a $200 billion deficit, could have the most serious repercussions. A deficit soaring toward $300 billion could result in a run on the dollar, higher interest rates, defaults by major Latin American debtor nations, and a banking crisis. The political response would be, as always, the printing of huge amounts of money (over and above the huge amounts we are printing today) and very high levels of inflation. What additional actions would be required to face unprecedented levels of capital flows is anybody's guess, but they are likely to be drastic and
unpleasant. There is no historical precedent for the huge amounts, and the extreme volatility, of capital floating around the world today.

The risks we are taking with our economy are severe; there is no need to do so. There is still time for a simple gasoline tax and a minimum level of taxation for individuals and corporations; this action, combined with a simple one-year expenditure freeze, would stabilize the situation, lower the levels of risk and allow for rational discussion of real long-term solutions. Democrats know that ultimately the growth in Social Security has to be curtailed. Republicans know that ultimately the growth in military spending has to be curtailed. Everyone knows taxes will have to be raised. It requires relatively little political courage to put this into effect and would result in relatively little pain; little, that is, compared to the alternative. It is, however, unlikely to happen.

Given this reality, it is clear that our actions must be of a defensive nature in Washington and of an activist nature here. By defensive, I mean that no tax reform bill is better than a bill that challenges any aspect of state and local tax deductibility. Why compromise on a critical local economic issue for the sake of fake tax reform? I also mean that no budget-balancing bill is better than Gramm-Rudman. The best that the sponsors of this legislation have been able to say is that it is better than
nothing. We cannot accept such an intellectually hollow argument. The alternatives are not Gramm-Rudman or nothing; the alternatives are Gramm-Rudman or serious work on the budget.

On the state and city level, there are a number of areas that deserve attention. In the financial area, the state is still facing considerable exposure with its continued huge requirement for short-term credit as a result of its spring borrowing. Long-term refinancing of part of this debt or, at the very least, splitting the borrowing into several pieces would reduce this risk. Both at the city and state level, prudent but continued downward pressure on individual income taxes should be exerted; our vulnerability to the elimination of state and local tax deductibility will not disappear. The best way to limit the risk is to reduce the levels of the taxes.

The New York Times recently asked a number of people what they considered to be the City's most urgent needs. My answer was public education and the reduction of school dropouts as well as affordable and civilized public transportation. There are obviously other large needs, affordable low and middle-income housing among others. More basic, maybe, is a question raised by many and more recently in a rather despairing speech by Senator Moynihan namely: have we become two cities, one rich and one poor, forever destined to drift further and further apart?. Pat
Moynihan's answer was: "Yes, and it is hopeless.". I am neither a blind optimist nor a dreamer, but I refuse to accept that answer. Yes, we are two cities, just as we are becoming two nations, but sound public policies by a realistic government, coupled with active private initiatives can and must remedy this situation.

The Municipal Assistance Corporation prides itself on being an example of public-private partnership: For the first decade of our existence we provided long-term financing to New York City until the City became credit worthy and self-sufficient once again. We had, by then, raised about $10 billion. We entered into a different phase at that point which culminated, in March 1984, in an Agreement between the Mayor, the Governor and MAC for the initial use of what became known as the "MAC Surplus".

Sound public financing practices require MAC to maintain large reserve funds to guarantee the timely payment of principal and interest on our outstanding bonds. The level at which we maintain these funds is geared to our peak-year debt service and is a primary responsibility of the MAC Board. That is one of the reasons for our wide market acceptance and at favorable rates. The interest income on these reserve funds, plus our ability to reduce debt service through selective refundings, constitute what is loosely referred to as "MAC surplus". The March 1984
Agreement committed MAC to provide NYC with $1 billion from fiscal 1984 through 1988 of which the city would use about one third for economic development projects, one half for capital projects and the balance for budget relief. The funds provided by MAC were to come from interest income and from bond issues and refunding operations which have been completed ahead of schedule. In view of the fact that the City may be facing new budgetary pressures in the future and that many of its needs require long-term plans and commitments, we are starting to work with the Governor's and the Mayor's staffs on the next phase of the MAC surplus, namely MAC II. We believe that we can produce, from various types of surpluses in our capital reserves, about $1.25 billion from 1989 through 1995. Appropriate advance refundings in the same period could provide an additional $200 million, for a total of about $1.5 billion.

Simultaneously with the beginning of this process, Governor Cuomo has asked his Council on Economic and Fiscal Priorities, to undertake a study, and to make recommendations, on the future financing requirements of the MTA; a subcommittee, of which I was appointed Chairman, has been created for that purpose. I am sure that I need not discuss, at the City Club, the vital role public transportation plays in the life of the City. Quite simply, a viable public transportation system is a matter of life-and-death to the City's economy.
At the present time, it is clear that the financial situation of the MTA must be stabilized on a long-term basis. One year band-aids, even if they appear to "save the fare" are no solution. I have the highest regard for the top management of the MTA; they are struggling with decades of neglect and decay as well as with inadequate labor/management relationships. Nonetheless, they are facing persistent questions with respect to the adequacy of both operations and capital investment programs, questions which will have to be answered satisfactorily.

The projected deficits of the TA (excluding commuter lines) alone are rather frightening: $224 million in 1986 and $322 million in 1987. These deficits, incidentally, assume an extension of the $200 million Business Tax Surcharge which is scheduled to expire in December 1986. In addition, the TA will have to raise a minimum of $1 billion annually for its capital programs which are now running at the rate of $850 million per annum. It is worth noting that due to the large capital programs which had to be undertaken, debt service is the most rapidly increasing expenditure category of the TA, going up 70% from 1985 to 1986 to a level of $100 million and projected to level off at $200 million per annum in 1990. The use of fare-backed bonds will continue to put upward pressures on the fare itself.
Clearly, a four-or-five-year plan will have to be adopted for the TA which will deal both with its capital requirements and its operating deficits. The question is no longer saving the 90¢ fare but rather can we limit increases over and above a $1 fare to the rate of inflation or less by rigid cost control, real productivity improvements through labor/management changes, and adequate as well as predictable taxing sources.

It is obvious that the TA's capital programs could be a potential user of some portion of MAC's surplus funds. This is an area which, together with the City and the State, we will be looking at along with many others. If it is to come about, however, it would have to meet the basic principles we have applied to any use of MAC surplus:

1) The MAC Board would have to determine that the funds would strengthen the long-term economic prospects of the City, thereby benefitting MAC bondholders; 2) The funds would have to be leveraged and conditioned on additional funds being committed as part of a total program; 3) The funds would have to be conditioned on an operating plan being adhered to, year-by-year, over the period involved. Whether a new control mechanism might also be required would have to be examined;
4) Whether new MAC legislation might be required would also have to be examined.

There would be an interesting historical symmetry in the use of some MAC surplus funds for TA capital purposes. For years the TA diverted borrowed funds, supposedly earmarked for capital investment, to pay for operating expenses. It would be poetic justice to use some non-borrowed funds for pay-as-you-go capital investment as a partial offset. However, the final decisions will be made on more concrete grounds.

I am certain that both the City and the State will have many programs that could absorb our surplus funds and which we will review together. The City, in the first full year of the original MAC surplus program, initiated a number of programs in housing, industrial retention, downtown development, adult literacy and computer education. The Mayor's initial report to the MAC Board is expected to make an impressive list of achievements. In addition, the City will undoubtedly have concerns with respect to its future budget needs. There is a general consensus on the MAC Board that, at a minimum, a part of our surplus funds should be used to accelerate the retirement of some outstanding MAC bonds. Clearly, such actions would produce considerable budget relief for the City, which, in turn, would provide a cushion against future cutbacks in Federal aid. This could
also be supplemented, in a favorable market environment, by refunding at lower interest rates, of some of the high coupon MAC issues presently outstanding.

We look forward to working with the City and the State on the MAC II surplus program, as we did on MAC I, both to provide assistance to the City's economy and improved long-term outlook for our bondholders.

In closing, I would like to address myself briefly to the question raised at the beginning of my remarks: Pat Moynihan's Tale of Two Cities. It is an undeniable fact that, in New York City as in the rest of the nation, the gap between wealth and need is getting greater. This is a current failing of democracy but it need not be terminal. A combination of enlightened government and public/private cooperation can ameliorate the situation:

- A welfare system that provides economic incentives for fatherless families can be changed to reverse this incentive.

- Our business community can work more closely with the public school system to prepare students more fully for tomorrow's job opportunities and reduce dropouts. New York business should give preference to New York graduates.
Ultimately, we should have, as an objective, a program whereby the business community can guarantee that a job will be open to every public school graduate who maintains a certain level of performance. There is no more urgent priority for the New York City Partnership than to work with the City on such a program.

Last, but not least, is charitable giving by New Yorkers. I do not believe that there is a city in the world which can match New York for the generosity of her citizens and their involvement with non-profit institutions. In many instances, however, our largest and most prestigious institutions appear to be raising huge amounts of funds more because they are able to raise them rather than because of a real need. The competition for funds and the overlapping roles of some of these institutions is wasteful, in times of need. And while dazzling benefit dinners are attended by our richest and most elegant New Yorkers, and millions of dollars are raised for golden institutions, it is increasingly difficult to find money for less glamorous needs. If our wealthiest institutions were to exercise more restraint over the proportion of charitable funds they try to absorb; if more of our most energetic, glamorous and wealthy citizens were to become involved with community houses, the "Y", shelters for the homeless and programs for unwed mothers; then New York would be a much better place for all her citizens.
New York City is the capital of the world. We have enormous problems and enormous capabilities. We have an energetic, popular Mayor; an able, thoughtful and committed Governor; a booming private sector and responsible labor leadership. We can do something about our Tale of Two Cities. We can only do so, however, if the efforts and progress and sacrifice we have made over the last ten years are not turned to ashes by the wishful thinking and the failure to face reality, presently dominating our national government.

* * *
ADDRESS GIVEN BY

FELIX G. ROHATYN

AT THE

1980 FINANCIAL CONFERENCE

OF THE

CONFERENCE BOARD

NEW YORK CITY

FEBRUARY 28, 1980
IT HAS BEEN APPARENT FOR SOME TIME THAT OUR ECONOMY WAS OUT OF CONTROL, OUR CURRENCY IN DANGER AND THAT THE ABILITY OF OUR GOVERNMENT TO REACT WAS INADEQUATE. INFLATION IS ACCELERATING, ONE IMMEDIATE CONSEQUENCE WAS OPEC’S RECENT DECISION TO GO TO QUARTERLY PRICING; ANOTHER WAS THE RECENT CHAOS IN THE CREDIT MARKETS. VARIOUS MEASURES HAVE BEEN TRIED, DOLLAR SUPPORT PACKAGES, GOLD SALES, WAGE PRICE GUIDELINES, WINDFALL PROFIT TAXES, BUT THE DETERIORATION HAS CONTINUED. WHAT IS HAPPENING TO THE U.S. IN 1980 IS SIMILAR TO WHAT HAPPENED TO NEW YORK CITY IN 1975, NAMELY A SLIDE TOWARDS BANKRUPTCY. THIS LED ME TO CONCLUDE LAST YEAR THAT AN APPROACH AT THE NATIONAL LEVEL SIMILAR TO THE ONE WE TOOK AT THE CITY/STATE LEVEL WAS NEEDED. THIS APPROACH INCLUDES:

1) A TEMPORARY 12-MONTH WAGE/PRICE FREEZE, TOGETHER WITH EXTREME BUDGETARY RESTRAINT. THIS SHOULD INCLUDE A CUT OF AT LEAST $20 BILLION IN CURRENT OUTLAYS TO BREAK INFLATIONARY EXPECTATIONS AND PROVIDE A SOLID BASE FROM WHICH TO ADOPT AN INTEGRATED, MULTI-YEAR ECONOMIC STRATEGY.

2) A SIGNIFICANT GASOLINE TAX (AT LEAST 50¢ PER GALLON) TO REDUCE CONSUMPTION, STRENGTHEN THE DOLLAR AND PROVIDE THE BASIS FOR A DIALOGUE WITH OPEC CONCERNING PRICING, LONG-TERM SUPPLY AND ALTERNATIVE PAYMENT METHODS FOR OIL. THE ONLY ALTERNATIVE TO A GAS TAX IS RATIONING, WHICH, IN MY JUDGEMENT IS A POOR SECOND BEST.
3) THE CREATION OF A BIPARTISAN COMMISSION MODELED AFTER FDR’S TEMPORARY NATIONAL ECONOMIC COMMISSION OF 1938 TO RECOMMEND AN INTEGRATED ECONOMIC STRATEGY, BOTH DOMESTIC AND INTERNATIONAL, FOR THE NEXT TWO DECADES. DOMESTIC AND INTERNATIONAL POLICIES ARE, AFTER ALL, SIDES OF THE SAME COIN.

MY POSITION HAS NOT CHANGED SINCE THEN. IT IS A POSITION THAT WAS GENERALLY CONSIDERED AT THE TIME TO HAVE NO POLITICAL POSSIBILITY OF REALIZATION, REGARDLESS OF THE MERITS. HOWEVER, VARIATIONS ON THIS THEME ARE NOW THE SUBJECT OF SOME DISCUSSION. IT WOULD BE NICE TO THINK THAT THIS HAD COME ABOUT THROUGH REASONED PUBLIC DEBATE BUT THE TRUTH IS THAT IT CAME ABOUT AS A RESULT OF THE WORKINGS OF THAT MOST BRUTAL OF REALISTS, THE PUBLIC MARKET. NEW YORK CITY’S POLITICAL LEADERS DID NOT WAKE UP TO REALITY UNTIL THE CREDIT MARKETS CLOSED ON THE CITY. NO ATTENTION WAS PAID TO THE FATE OF THE DOLLAR UNTIL THE INTERNATIONAL MONETARY MARKETS COLLAPSED IN THE FALL OF 1978. THE PRESENT NEAR COLLAPSE OF THE CREDIT MARKETS IS FINALLY FOCUSING THE ATTENTION OF THE GOVERNMENT AND THE PUBLIC ON WHAT HAS BEEN THE INESCAPABLE REALITY FOR SOME TIME, NAMELY THAT WE ARE HEADED FOR A NATIONAL BANKRUPTCY, IN THIS CASE CALLED RUNAWAY INFLATION.

JOHN KENNEDY IN A COMMENCEMENT ADDRESS AT YALE SAID: "THE GREAT ENEMY OF TRUTH IS VERY OFTEN NOT THE LIE-DELIBERATE, CONTRIVED AND DISHONEST, BUT THE MYTH, PERSISTENT, PERSUASIVE AND UNREALISTIC. WE HOLD FAST TO THE CLICHES OF OUR FOREBEARS, WE ENJOY THE COMFORT OF OPINION WITHOUT THE DISCOMFORT OF THOUGHT."
SINCE THE OPEC OIL EMBARGO OF 1973 WE HAVE BEEN LIVING WITH A MYTH, AS COMFORTABLE AND PERSISTENT AS IT IS UNREALISTIC, THE MYTH THAT THIS COUNTRY, WITH AN ECONOMIC AND SOCIAL STRUCTURE BASED ON AMPLE AND CHEAP ENERGY AS WELL AS AMPLE AND CHEAP CREDIT COULD ADJUST TO AN EXPLOSION IN THE COST, AS WELL AS A CONTRACTION IN THE AVAILABILITY OF, BOTH OF THESE ELEMENTS. IT CANNOT BE DONE WITHOUT IMPORTANT CHANGES IN OUR WAY OF LIFE AS WELL AS IN MANY OF OUR INSTITUTIONS. BECAUSE OF THE NEAR COLLAPSE OF THE MARKETS A NATIONAL ECONOMIC EMERGENCY HAS BEEN DISCOVERED WHICH HAS BEEN LATENT FOR YEARS JUST AS THE CRISSES OF NEW YORK CITY WAS MADE INEVITABLE BY THE PREVIOUS DECADE TO KEEP THE CITY OUT OF BANKRUPTCY WE CONTRIVED A SET OF POLICY GOALS AIMED AT REDUCING BUDGET GAPS (IN REAL, NOT ACCOUNTING TERMS), STRETCHING OUT DEBTS AND STIMULATING THE LOCAL ECONOMY. THE CREATION OF NEW STRUCTURES SUCH AS THE EMERGENCY FINANCIAL CONTROL BOARD AND MAC PLAYED IMPORTANT ROLES IN BRINGING TOGETHER BUSINESS, LABOR AND GOVERNMENT AND WERE CRITICAL ELEMENTS IN THE BASIC BARGAINS, THE SO-CALLED SOCIAL CONTRACTS, THAT WERE STRUCK WITH EACH. LABOR AGREED TO SEVERELY LIMIT ITS WAGE INCREASES, TO COMMIT ITS PENSION SYSTEMS TO MASSIVE INVESTMENTS AND TO MAJOR WORK FORCE REDUCTIONS IN EXCHANGE FOR ATTRITION RATHER THAN LAYOFFS AND FOR THE SOLVENCY OF THEIR RETIREMENT SYSTEMS IF WE MAINTAINED THE SOLVENCY OF NEW YORK, THE BANKS AGREED TO STRETCHOUTS, INTEREST RATE REDUCTIONS AND NEW
INVESTMENTS IN EXCHANGE FOR THE CREATION OF THE EMERGENCY FINANCIAL
CONTROL BOARD ANDMAC TO PROVIDE GREATER SAFETY FOR THEIR BONDS;
AND THE STATE AND FEDERAL GOVERNMENTS AGREED TO THEIR ROLES AS PART
OF THE OVERALL BARGAIN AND AS BETTER ALTERNATIVES TO BANKRUPTCY.
IN LOOKING AT THE NATIONAL PICTURE AND THE BASIC SET OF
RECOMMENDATIONS THAT I AM MAKING, ONE MUST ALSO LOOK AT THE
BASIC BARGAINS THAT MUST BE STRUCK AND TO RELATE THEM TO EACH
OTHER AND TO THE STRUCTURES THAT GO WITH IT. LET ME STATE THAT
I DO NOT VIEW BARGAINS AS IN ANY SENSE INVIDIOUS; THEY ARE THE
ESSENCE OF THE DEMOCRATIC PROCESS. THEY ARE THE ALTERNATIVE
TO DICTATORSHIP AT HOME AND MILITARY ACTION ABROAD AND, SINCE
BOTH DOMESTIC AND INTERNATIONAL ACTIONS ARE REQUIRED LET US EXAMINE
THOSE BARGAINS IN GREATER DETAIL.

1) THE FIRST AND BASIC BARGAIN INVOLVES BUSINESS-LABOR AND
GOVERNMENT IN THE WAGE/PRICE FREEZE,
AND COMMITMENT TO HARSH BUDGET
RESTRAINT: THIS SHOULD TAKE PLACE SIMULTANEOUSLY WITH THE IMPOSITION
OF THE GAS TAX (OR RATIONING) AND THE CREATION OF TEMPORARY NATIONAL
ECONOMIC COMMISSION. THESE ACTIONS SHOULD DAMPEN INFLATIONARY
EXPECTATIONS AND PSYCHOLOGY AND PROVIDE THE BREATHING SPELL NEEDED
TO SET LONG-TERM POLICIES IN PLACE. TOGETHER WITH THE STRENGTHENING
OF THE DOLLAR RESULTING FROM THE GAS TAX THEY SHOULD RESULT IN A
SIGNIFICANT REDUCTION IN INTEREST RATES, WHICH HAVE THEMSELVES
BECOME A STRONG INFLATIONARY FACTOR AND A RESUMPTION OF MORE NORMAL
FUNCTIONING OF THE FINANCIAL MARKETS. A REDUCTION IN INTEREST RATES CAN ONLY BE COUPLED WITH BUDGET RESTRAINT. IT IS CRITICALLY NEEDED.

2) THE SECOND BARGAIN FUNDAMENTAL TO ANY PLAN IS THE BARGAIN WITH OPEC. IN 1980 OUR PAYMENTS TO OPEC WILL APPROACH $100 BILLION, 10 TIMES WHAT THEY WERE 5 YEARS AGO. THE VALUE OF ALL COMPANIES LISTED ON THE NYSE IS LESS THAN $1,000 BILLION AND THE NOTION THAT, OVER THE NEXT 5 YEARS, WE WILL MORTGAGE TO OPEC HALF OF OUR PRODUCTIVE CAPACITY, BUILT UP OVER 200 YEARS, TO PAY FOR A PRODUCT WE BURN EVERY DAY IS OBVIOUSLY UNSUSTAINABLE. WE CANNOT AFFORD LOSS OF SUPPLY; NEITHER CAN WE AFFORD TO PAY FOR IT. THE ECONOMIC IMPACT OF THESE PAYMENTS IS SIMILAR TO THE REPARATIONS IMPOSED ON GERMANY AFTER WORLD WAR I, BOTH INFLATIONARY AND DEFLATIONARY. RECYCLING IS NOT THE ANSWER; IT IS ONLY A MECHANISM TO LEND MORE AND MORE MONEY TO PEOPLE WHO CAN AFFORD IT LESS AND LESS. THE MULTINATIONAL BARGAIN WITH OPEC THEREFORE HAS TO INCLUDE.

A) COMMITMENTS ON THE PART OF OPEC TO LONG-TERM SUPPLY AND TO LONG-TERM PRICE STABILITY.

B) COMMITMENTS ON THE PART OF THE U.S., THE OECD AND JAPAN TO REDUCE CONSUMPTION AND INCREASE ALTERNATE SOURCES OF ENERGY.
C) COMMITMENTS ON THE PART OF THE WEST TO PROTECT MILITARILY THE EXPOSED MEMBERS OF OPEC SUCH AS THE SAUDIS AND KUWAIT.

D) COMMITMENTS ON THE PART OF THE U.S., SPECIFICALLY, TO MAINTAIN THE PURCHASING POWER OF THE DOLLAR.

E) COMMITMENTS ON THE PART OF OPEC (OR CERTAIN OF ITS MEMBERS SUCH AS THE SAUDIS AND KUWAIT) TO ACCEPT LONG-TERM BONDS IN PAYMENT FOR OIL, THE PROCEEDS OF WHICH WOULD BE LIMITED TO PURCHASES OF AMERICAN GOODS AND SERVICES, POSSIBLY BACKED, IN PART, BY SOME OF OUR GOLD RESERVES.

F) COMMITMENTS ON THE PART OF OPEC TO FINANCE THE LDC'S DIRECTLY OR THROUGH GREATER CONTRIBUTIONS TO THE IMF.

G) COMMITMENTS ON THE PART OF EUROPE, JAPAN AND SOME OF THE OPEC PRODUCERS TO SHARE IN THE COSTS OF THE SECURITY OF THE REGION.

THE GAS TAX IS THE KEY TO BEING ABLE TO STRIKE THE MAJOR PART OF THESE BARGAINS. IT WILL IMMEDIATELY STRENGTHEN THE DOLLAR AND REDUCE U.S. CONSUMPTION. NEITHER THE EUROPEANS NOR OPEC WILL BELIEVE WE ARE SERIOUS ABOUT CONSERVATION WITH LESS THAN $2 PER GASOLINE OR UNLESS WE INSTITUTE RATIONING.
At 50¢ per gallon, such a tax would produce a minimum of $50 billion per annum initially, part of which could fund the military programs needed to credibly protect some of the producers. It is estimated to reduce consumption by 10% and will enable the Europeans, the Japanese and the Saudis and Kuwaits themselves, to justify politically their financial participation in the military security of the Persian Gulf. By strengthening the dollar it would make long-term bonds a more acceptable method of payment for oil.

3) The Temporary National Economic Commission would be appointed by the President, subject to Congressional confirmation, with representation from business, labor, academia and government. It would recommend to the President and Congress, prior to the expiration of the wage/price freeze:

A) A mechanism for a limited period of wage/price restraint following the expiration of the freeze. An incomes policy or other transitional mechanism leading back to a full and free market will be needed, and the commission should be charged with that responsibility.

B) A tax program, including the proceeds of the gas tax, aimed at increasing investment and productivity, easing the energy cost burden on lower income groups and aiming
AT A TRULY BALANCED FEDERAL BUDGET NEXT YEAR. THIS BALANCE SHOULD INCLUDE OFF-BUDGET ITEMS AMOUNTING TO $17 BILLION PRESENTLY NOT INCLUDED IN THE FEDERAL DEFICIT, AND FREEZE, AT THEIR PRESENT LEVEL, THE AMOUNT OF FEDERAL GUARANTEES WHICH HAVE INCREASED BY $100 BILLION OVER THE LAST 5 YEARS. IT SHOULD RESULT IN A HIGHLY RESTRICTIVE BUDGET POLICY.

C) IN A MORE GENERAL SENSE, THE COMMISSION MUST RECOMMEND AN ECONOMIC STRATEGY FOR THE U.S. FOR THE NEXT TWO DECADES. IT MUST DO SO FOR TWO BASIC REASONS: FIRST, BECAUSE NOWHERE IN GOVERNMENT TODAY DOES STRATEGIC ECONOMIC PLANNING TAKE PLACE; SECOND, BECAUSE DIFFICULT, CONTROVERSIAL POLICIES MUST ORIGINATE FROM NON-POLITICAL, CREDIBLE BODIES, CREATED IN AN ATMOSPHERE OF EMERGENCY, TO GENERATE THE POLITICAL SUPPORT ENABLING THE PRESIDENT AND CONGRESS TO ACT. WE CAN NO LONGER ASSUME THAT A GRADUAL, PIECEMEAL APPROACH TO OUR ECONOMIC PROBLEMS CAN WORK; THE BASIC RULES OF THE GAME HAVE BEEN CHANGED TO SUCH AN EXTENT THAT A REEXAMINATION OF THE ENTIRE STRUCTURE IS NEEDED. NOBODY TODAY HAS ALL THE ANSWERS BUT AT LEAST IT WOULD BE USEFUL TO RAISE SOME OF THE QUESTIONS. THESE WOULD INCLUDE:

A) FARM AND FOOD POLICY. HOW DO WE RECONCILE SUPPORT PRICES AND ACREAGE ALLOCATION WITH THE NEED FOR LOW
PRICES AT HOME, EXPORTS TO HELP THE DOLLAR, AND ADEQUATE INCOME FOR THE FARMER.

b) TRADE AND EMPLOYMENT. HOW DO WE RECONCILE AN INTERNATIONAL FREE TRADE POLICY THAT WE PRACTICE AND OTHERS PREACH WITH THE NEED TO CREATE MILLIONS OF MANUFACTURING JOBS FOR YOUNG BLACKS AND HISPANICS IN THE URBAN GHETTOES. A ZERO-GROWTH ECONOMY CONDEMNS THE POOR AND THE UNEMPLOYED TO UTTER HOPELESSNESS.

c) ALTERNATIVE ENERGY. CONSERVATION ALONE CANNOT SUSTAIN THE GROWTH OF THE ECONOMY NEEDED TO PROVIDE JOBS. NUCLEAR POWER IN FRANCE, COAL IN GERMANY HAVE ENABLED THOSE COUNTRIES TO REDUCE DEPENDENCE ON OIL WITHOUT SUFFERING DRAMATIC DOWNTURNS AND INFLATION. A SIMILAR CHOICE CLEARLY WILL HAVE TO BE MADE HERE. IT SEEMS SO FAR POLITICALLY ELUSIVE.

REGIONS OF THE NORTHEAST AND MIDWEST WILL ACCELERATE. THE SOUTH AND WEST WILL PRODUCE GUNS AND OIL; THE NORTHEAST AND MIDWEST, UNEMPLOYMENT AND SLUMS. A UNION OF STATES CANNOT SURVIVE WITHOUT A SHARING OF BURDENS AND BENEFITS; IT IS NO COINCIDENCE THAT CHICAGO, CLEVELAND, PHILADELPHIA AND NOW WASHINGTON, D.C. HAVE RECOGNIZED THE SAME PROBLEMS WITH WHICH NYC HAS BEEN STRUGGLING FOR 5 YEARS. IF MUCH OF OUR WEALTH IS TO GO TO OTHER PARTS OF THE COUNTRY, SO SHOULD MUCH OF OUR WELFARE AND MEDICAID COSTS. IT IS IMPERATIVE THAT THIS SITUATION BE ANTICIPATED AND MET WITH A PERMANENT BURDEN-AND-REVENUE SHARING ON THE NATIONAL LEVEL. IT IS HYPOCRISY TO PRETEND THAT, IN THE PRESENT ENVIRONMENT, WE CAN BALANCE THE BUDGET OF NY AND KEEP IT BALANCED, AND THE CITY LIVEABLE, ON A LONG-TERM BASIS.

E) AN INDUSTRIAL STRATEGY WHICH, COUPLED WITH TAX POLICY, WILL HAVE AS ITS OBJECTIVE TO REVERSE THE DECLINE OF THE MANUFACTURING SECTOR IN OUR ECONOMY. IN MY JUDGEMENT OUR ECONOMY'S BASE SHOULD BE BALANCED AS BETWEEN SERVICES AND MANUFACTURING, WITH THE EMPHASIS, HOWEVER ON MANUFACTURING.

POLICY IS A FABRIC, A TAPESTRY IN WHICH ALL STRANDS ARE INTERWOVEN, LINKED TO EACH OTHER DESCRIBING A BASIC POSTURE AND DIRECTION. WE HAVE NO SUCH CONSISTENT INTEGRATED POLICIES TODAY. POLICY INITIATIVES SEEM TO BE HAPHAZARD, UNRELATED TO EACH OTHER. IN TODAY'S WORLD MORE THAN EVER BEFORE, DOMESTIC ECONOMIC POLICIES MUST BE LINKED WITH INTERNATIONAL MONETARY, TRADE AND SECURITY POLICIES. THE TEMPORARY COMMISSION, HOPEFULLY WOULD BE ABLE TO ARRIVE AT AN
INTEGRATED, BALANCED SET OF POLICIES, CONSIDER THE TRADEOFFS AND COMPROMISES THAT WILL INVITABLY BE REQUIRED, MAKE THEIR RECOMMENDATIONS TO THE PRESIDENT AND CONGRESS AND GO OUT OF BUSINESS. IF ITS MEMBERSHIP IS CREDIBLE IT WILL DEVELOP POLITICAL SUPPORT FOR ITS POSITIONS.

THERE ARE NO PERFECT SOLUTIONS AND NO ASSURANCES OF SUCCESS. IT IS ARGUED THAT WAGE AND PRICE CONTROLS HAVE NOT WORKED IN THE PAST. THAT DOES NOT MEAN, IN MY JUDGEMENT, THAT A TEMPORARY FREEZE IN AN ENVIRONMENT OF RESTRAINT, COULD NOT BE SUCCESSFUL WHILE OVERALL POLICIES ARE PUT IN PLACE. IT IS ARGUED THAT A GAS TAX IS POLITICALLY IMPOSSIBLE AND, IF ANYTHING, RATIONING WOULD BE EASIER. BUT EVERYONE AGREES THAT TAX CUTS AIMED AT INVESTMENT ARE NECESSARY, INCREASED MILITARY EXPENDITURES ARE NECESSARY, BALANCING THE BUDGET IS NECESSARY. THOSE CANNOT HAPPEN WITHOUT REVENUES AND RATIONING WILL NOT PRODUCE REVENUE. I AM AWARE OF THE RISKS, THE PROBLEMS AND THE DIFFICULTIES OF WHAT I SUGGEST. BUT A CONTINUED POLICY OF INEFFECTIVE GRADUALISM SEEMS TO ME INFINITELY MORE DANGEROUS.
WE ARE AT A TURNING POINT IN OUR ECONOMIC, SOCIAL AND POLITICAL LIFE. IT HAS BEEN COMING FOR A LONG TIME AND IT WILL TAKE A LONG TIME TO ADJUST TO THE NEW REALITIES. IF THE IMPETUS FOR REEXAMINATION DOES NOT COME FROM THE POLITICAL LEADERSHIP SEEKING SOLUTIONS, IT WILL COME FROM THE MARKETS DEMANDING THEM. DEMOCRACY NO LONGER INVOLVES A SOCIAL CONTRACT BY WHICH THE MINORITY COMPLIES WITH THE WILL OF THE MAJORITY; CONSEQUENTLY THERE IS A CLEAR DANGER THAT CONTINUED DEADLOCK OVER MANY OF THESE ISSUES, OR CONTINUED APPLICATION OF BANDAIDS, WILL ULTIMATELY CREATE SOCIAL AND POLITICAL UPHEAVALS OF UNFORESEEABLE DIMENSIONS WHAT WE ARE FACING IS NOT ONLY A SUDDEN ECONOMIC EMERGENCY CAUSED BY A FEW UNPREDICTABLE SHOCKS. WE ARE FACING A POLITICAL AND SOCIAL CRISIS OF MAJOR DIMENSIONS, CHALLENGING DEMOCRACY HERE AT HOME AS NOTHING HAS DONE SINCE THE 1930'S. THE SOCIAL FABRIC TODAY IS NOT AS RESILIENT AS IT WAS THEN; IN MANY PARTS OF THE COUNTRY IT IS TAUT AS A BOWSTRING, TIGHT AS A DRUM. IF PUSHED HARD IT WILL NOT GIVE BUT WILL COME APART. IT IS NOT A RISK WORTH TAKING. THE TIME IS AS LATE FOR THE U.S. IN 1980 AS IT WAS FOR NYC IN 1975.
TESTIMONY BY
FELIX G. ROHATYN, CHAIRMAN
MUNICIPAL ASSISTANCE CORPORATION FOR THE CITY OF NEW YORK

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

FEBRUARY 7, 1980
Mr. Chairman, Members of the Committee:

I would like to report on the status of the Four Year Debt Issuance Plan and MAC's participation in that financing package, as well as our view of the City's budget and our future prospects. We are reaching the halfway mark of this program which was constructed in 1978. The aggregate 4-year financing package amounting to $4.5 billion called on MAC to raise $2.8 billion through public and private sales of MAC bonds, for the City to sell $750 million in federally guaranteed bonds to union pension systems and New York City bonds in the amount of $950 million to be sold publicly in the last two years of the Plan. As backups for contingencies were $900 million of guarantees available under the law and significant additional economic capacity of MAC which I will come back to later in my testimony.

The financing plan is evolving on schedule. As called for in the timetable, MAC has so far issued a total of $1.8 billion of its bonds—$901 million during fiscal year 1979 and $948 million to date during fiscal year 1980. The $1.8 billion has been raised from the following sources:

--$938 million from private placement to various financial institutions and City Pension Funds according to the terms of the November 1978 Agreement,
--$64 million from an exchange with the New York State Insurance Fund, and
--$847 million from public sales

As a direct result of these financings, the City's seasonal borrowing requirements have been reduced from approximately $1.9 billion required in 1978, to approximately $650 million required during fiscal years 1979 and 1980. The short-term credit market viewed this development positively, enabling the City to sell publicly, for the first time since 1975, $275 million of its Notes to meet a portion of its 1979 seasonal financing requirements.

To date, during fiscal year 1980, the City has sold $350 million of its Notes publicly, and expects to meet the balance of its 1980 seasonal requirements from public sales.

A portion of the Corporation's issuances under the plan aggregating $642 million have been for refunding. The refundings have produced a more stable debt service structure which will assist MAC in meeting possible shortfalls in the City's own long-term financing program. They have also been accomplished so as to reduce MAC's average interest cost for the refunded debt by over 100 basis points at a time of an unprecedented climb in the level of interest rates. The refundings have also produced approximately $250 million of net budgetary savings for the City for the period 1980 to 1985, ahead of the schedule committed to at the time of the first Four Year Plan. During
The 1975-76 period, as you will surely remember, MAC had to refinance some $5 billion of City short-term Notes and to finance the City's operating deficits and capital programs. This occurred during difficult markets and under conditions that were often chaotic. The resulting debt structure included many short-maturity, high interest series of bonds which created enormous budgetary pressures at the time of greatest fragility for the City. This is what we have been dealing with in our overall program to level out our maximum debt service at roughly the $650 million per annum level. Although we have not yet reached that level, it is noteworthy, that, with $6.18 billion in presently outstanding bonds, MAC's maximum debt service in any future year is approximately $780 million while New York City, with about $6 billion in bonds outstanding has current debt service of about $1.1 billion per annum. Lowering our maximum debt service obviously gives MAC greater economic capacity to carry the City in times of need. Furthermore, as long as it remains obvious that inflationary expectations will remain at or near double digit rates, stretching out our debt instruments to 20-25 years at 8-9% interest rates seems to me to be a clear and simple duty. If current trends continue we may, in a few years, no longer have viable markets for long-term, fixed interest rate bonds in this country; we need only to look to Europe for examples.

With regard to the City's budget, it has been the position of the Corporation for some time that the adoption of those
MEASURES WHICH ARE ULTIMATELY REQUIRED TO ACHIEVE BALANCE
SHOULD NOT BE POSTPONED UNTIL THE FINAL YEAR OF THE PLAN. WE
HAVE BEEN CONCERNED THAT GAPS NOT BE CLOSED PRIMARILY ON THE
REVENUE SIDE OF THE BUDGET. A SERIES OF NONRECURRING REVENUES,
AS WELL AS REVENUE INCREASES RESULTING FROM INFLATION, PROVIDE
AN INSECURE FOUNDATION ON WHICH TO BUILD CREDIBLY BALANCED
BUDGETS. THEREFORE, WE APPLAUD THE DECISION OF THE MAYOR TO
SUBMIT A BUDGET BALANCED ACCORDING TO GENERALLY ACCEPTED
ACCOUNTING PRINCIPLES ONE YEAR BEFORE IT IS REQUIRED. IT IS
A SINGULARLY IMPORTANT STEP. IT IS AN ACTION FOR WHICH THE
MAYOR SHOULD BE COMMENDED, FOR IT DEMONSTRATES CLEARLY A
RECOGNITION BY THE CITY OF THE NEED TO ACT WITHOUT DELAY AND
THE WILLINGNESS TO IMPLEMENT PAINFUL, BUT NECESSARY, BUDGET
CUTS.

THIS IS NOT MEANT TO LULL US INTO ANY FALSE SENSE OF SECURITY.
EVEN WITH THE ADOPTION OF A BUDGET BALANCED ACCORDING TO GAAP
FOR FISCAL YEAR 1981, THERE ARE CONTINUING PROBLEMS WHICH MUST
BE ADDRESSED BY THE CITY OVER THE LONG TERM: THE COST OF
FUTURE WAGE SETTLEMENTS WITH MUNICIPAL EMPLOYEES; THE LIKELIHOOD
OF CONTINUED DEFICIT SPENDING BY THE HEALTH AND HOSPITALS
CORPORATION, THE BOARD OF EDUCATION AND THE TRANSIT AUTHORITY;
AND, THE NEED FOR CONTINUING INCREASES IN THE LEVELS OF FEDERAL
AND STATE AID, THE MAJORITY OF WHICH RESULT FROM MANDATED
PROGRAMS.
Further, the City has to date not succeeded in ministering to its own physical needs. The resources made available to it in this Four Year Financing Plan have not yet been fully applied to those deteriorating streets, sewers, bridges and parks which require immediate attention. The City, together with the State and its agencies, must develop the capacity to plan and execute the restoration of its physical plant. The City and State together must put greater focus on the job-creating, revenue-producing side of the economy that, in the long-run, is going to be the key to our success or failure.

The achievement by the City of a GAAP balanced budget now, and the prospects for repeated balanced budgets in the future, continue to be the single most important test for gaining entry into the credit markets. It is the mark of fiscal stability toward which the investment community has looked since the City's crisis began. While the City does not now have market access for its bonds, the adoption and implementation of a balanced budget for fiscal year 1981, and, the adoption in June 1981 of a balanced budget for fiscal year 1982 should encourage those agencies which rate municipal bonds to recognize the progress which the City has made and assign an investment-grade rating to long-term City securities.

It comes, however, as no great surprise that investment rating services such as Moody's would be more than normally skittish with respect to rating City bonds. The history of the City,
THE MASSIVE AMOUNTS INVOLVED, THE ECONOMIC TRENDS CLEARLY ADVERSE TO THE NORtheast, THE CURRENT TRAVAILS OF CHICAGO, CLEVELAND, PHILADELPHIA, ETC. ALL CONTRIBUTE TO THEIR RESERVE. IN EARLIER TESTIMONY IN FRONT OF THIS COMMITTEE I STATED MY VIEW THAT 2 OR 3 CONSECUTIVELY BALANCED BUDGETS UNDER GAAP MIGHT BE REQUIRED TO PROVIDE FULL MARKET ACCESS TO THE CITY. I BELIEVE MY PREDECESSOR, GEORGE GOULD, GAVE A SIMILAR VIEW IN TESTIMONY LAST YEAR. ALTHOUGH THE FOUR YEAR PLAN CALLS ON THE CITY TO SELL $300 AND $650 MILLION OF LONG-TERM BONDS IN FISCAL 1981 AND 1982 RESPECTIVELY, IT WAS ALWAYS RECOGNIZED THAT THIS MIGHT BE OPTIMISTIC AND THAT MAC SHOULD BE THERE AS THE FIRST BACKUP, BEFORE THE AVAILABLE LOAN GUARANTEES. THIS IS THE CASE, NOT ONLY THROUGH 1982 BUT, FROM AN ECONOMIC CAPACITY POINT OF VIEW, INTO 1984 AND POSSIBLY BEYOND. DURING THIS PERIOD OF TIME, THE MUNICIPAL ASSISTANCE CORPORATION IS PREPARED BOTH TO FULFILL ITS OWN PART OF THE FOUR YEAR DEBT ISSUANCE PLAN, AND TO ISSUE SUCH ADDITIONAL DEBT AS MAY BE REQUIRED BY THE CITY'S CAPITAL PROGRAM, WHICH WAS TO BE MADE UP OF CITY BONDS.

As you are aware, MAC's ability to issue debt is constrained on several levels:

- The economic capacity to issue and support debt is limited principally by two tests. The Corporation has covenanted not to issue additional First Resolution Bonds if the maximum annual debt service payments under
that Resolution in any future year would exceed $425 million. MAC has further convenanted not to issue additional Second Resolution Bonds unless available revenues would cover maximum annual debt service payments under that Resolution in any future year at least two times.

- It is difficult to give you an exact estimate of MAC's additional economic capacity (as opposed to market acceptance) to carry debt. The obvious variables are revenue assumptions on the one hand, and assumptions as to the type, maturity and interest rates on our bonds on the others. It would be reasonable to assume at this point, that by 1984, given continued satisfactory market acceptance, MAC could comfortably support an aggregate in excess of $10 billion of outstanding long-term debt.

-MAC's statutory capacity to issue debt (exclusive of the bonds issued for refunding) is $8.8 billion. To date, the Corporation has issued $6.8 billion.

-The Bond Purchase Agreement (under which $2.8 billion of MAC bonds are to be sold as part of the Four Year Debt Issuance Plan)
ALSO LIMITED THE LEVEL OF OUTSTANDING BONDS to $8.8 billion. That Agreement further prohibits MAC from issuing other than First or Second Resolution Bonds until such time as the City has an investment-grade rating.

The capacity of the credit market to absorb new MAC debt limits the amount we can issue in any year. This is especially true in markets as irregular as the ones we are now experiencing. We are told by our managing underwriters that $600-$750 million of new debt is the maximum we should attempt to sell in one year.

Despite these constraints, MAC has the capacity to assist the City beyond the scope of the current Plan. The Corporation is already scheduled to place, pursuant to the Bond Purchase Agreement, $537 million of its Bonds in 1981 (of which $353 million is for capital purposes) and $324 million of its Bonds in 1982. It is our estimate that the City’s needs will require that MAC issue approximately $675 million in fiscal years 1981-82 over and above the Plan in order to fund both the City capital and the Corporation’s debt service reserve requirements, if the City fails to market its own securities. This would bring MAC to the end of the Four Year Plan with an aggregate $8.3 billion of debt issued.

Beyond 1982, we anticipate that the City’s capital needs will be in the range of $850-$900 million per year. If MAC were required to finance 100% of the City’s capital needs through
1984 ON THIS SCHEDULE, OUR TOTAL ISSUANCE WOULD RISE TO ABOUT $10.1 BILLION. I DO NOT ANTICIPATE THIS HAPPENING. IF THE CITY CONTINUES ON TRACK, WITHIN A REASONABLE ECONOMIC ENVIRONMENT, THE CITY CAPITAL FUNDING REQUIREMENTS OF 1983 AND 1984 COULD BE MET THROUGH A COMBINATION OF MAC ISSUANCES SUPPLEMENTED IN EVER-INCREASING AMOUNTS BY THE CITY’S OWN DEBT. IT IS ENTIRELY PLAUSIBLE THAT THE CITY, HAVING IMPLEMENTED FOUR CONSECUTIVE GAAP BALANCED BUDGETS AND HAVING SUCCESSFULLY ISSUED EVER-LARGER AMOUNTS OF DEBT FOR TWO YEARS, WOULD THEN BE ABLE TO FULLY MEET ITS OWN CAPITAL NEEDS.

A SCENARIO SUCH AS I HAVE JUST OUTLINED REQUIRES THAT MAC ISSUE DEBT IN 1981 AND 1982 BEYOND THAT WHICH IS CURRENTLY PLANNED. WE ARE PREPARED TO DO SO. IT ALSO REQUIRES MAC TO ISSUE DEBT BEYOND ITS CURRENT STATUTORY AUTHORIZATION. WE ARE PREPARED TO RECOMMEND TO THE GOVERNOR AND TO STATE LEGISLATURE THAT MAC’S AUTHORITY TO ISSUE DEBT BE EXTENDED THROUGH FISCAL 1984 AND ITS CEILING RAISED BY APPROXIMATELY $1.2 BILLION TO $10 BILLION, THEREBY SUSTAINING THE CITY AND ITS VITAL PHYSICAL RECONSTRUCTION ACTIVITIES WITHOUT ANY ADDITIONAL FEDERAL ASSISTANCE.

EVEN THOUGH MAC CARRIES THE MORAL OBLIGATION OF THE STATE, I DO NOT BELIEVE SUCH AN INCREASE WOULD ADVERSELY AFFECT THE STATE’S CREDIT. MAC IS VIEWED BY CREDIT RATING AGENCIES AND
INVESTORS AS ESSENTIALLY SECURED BY ITS REVENUE STREAM OF
SALES TAXES AND PER CAPITA STATE AID. THIS STREAM OF REVENUE
LAST FISCAL YEAR AMOUNTED TO $1.9 BILLION AS AGAINST MAXIMUM
DEBT SERVICE REQUIREMENTS IN 1989 OF $786 MILLION. MAC,
 THEREFORE, SHOULD NOT BE A BURDEN AGAINST THE STATE'S GENERAL
CREDIT. THE STATE'S GENERAL CREDIT SITUATION HOWEVER, DOES
AFFECT MAC. WE WERE CONCERNED RECENTLY, WHEN UNCERTAINTIES
WITH RESPECT TO THE STATE'S BUDGET CAUSED A SLIGHT DOWNGRADE IN
THE STATE'S GENERAL OBLIGATIONS BY: STANDARD & POOR'S. THE
STATE'S CREDIT RATING, AS A PRACTICAL MATTER, CONSTITUTES A
CEILING AGAINST WHICH MAC HAS TO OPERATE. IT IS VITAL TO
MAC, AND TO THE FINANCING PLAN, THAT THE CREDIT AND BUDGETARY
POSTURE OF THE STATE REMAIN IMPECCABLE. I HAVE SO STATED TO
THE GOVERNOR IN THE STRONGEST POSSIBLE TERMS.

WE BELIEVE THIS PROGRAM SHOULD SEE THE CITY THROUGH. HOWEVER,
WE MUST REMEMBER THAT, BY NOW, MAC HAS BECOME THE LARGEST
ISSUER OF LONG-TERM MUNICIPAL BONDS IN THE COUNTRY, HAVING
PASSED THE STATE OF CALIFORNIA SOME TIME BACK AND WE DO NOT
REACH TO INFINITY.

A PERSUASIVE CASE CAN BE MADE FOR SUCH A SCENARIO AS I HAVE
JUST DESCRIBED; BUT, IN LIGHT OF SOME OF THE TESTIMONY MADE
TO THIS COMMITTEE ONLY LAST WEEK, WE MUST ALSO BE PREPARED
FOR SOME ALTERNATIVE SET OF EVENTS. THEY MIGHT INCLUDE THE
FOLLOWING:
A Sharply Deteriorating National Economic and International Monetary Environment,

Revenue assumptions included in the City's budget which fail to materialize,

Expenditure reduction targets which are not fully met

A slower than anticipated process of restoring investment-grade ratings to City bonds, and

Debt markets so tight that credits perceived as weaker, such as New York City, are denied full access

If some pattern of events similar to these were to materialize, the need to support the City's capital spending program might extend for a couple of additional years. While MAC might have ample economic capacity to do so, this should not be equated with unlimited market access. In such a case, -- in order to avoid seeking additional Federal assistance beyond 1982 by extending MAC's ability to assist the City over a longer period -- it might become advisable to utilize some portion of those Federal guarantees which are available in 1982 under the current law. These guarantees, in supplement to MAC's issuing debt under the two Resolutions, and possibly issuing pursuant to a new Resolution, could carry the City even under this more severe set of circumstances, until such time as it could support itself.
Under normal circumstances this should not be necessary. We live in unusual times, however, and while I do not anticipate the necessity to make use of the guarantees in 1982, I cannot rule out that this second set of circumstances might occur. However, regardless of which one materializes, given a combination of:

--resolve on the part of elected City officials, to act decisively now, to bring the budget into balance,

--the cooperation of those governments which reside in Albany and Washington, and

--a viable economic environment for urban America

I do not anticipate that either the City, the State or MAC would turn to Washington after 1982 in search of additional financing assistance.
TESTIMONY BY

FELIX G. ROHATYN, CHAIRMAN

MUNICIPAL ASSISTANCE CORPORATION FOR THE CITY OF NEW YORK

BEFORE THE

JOINT ECONOMIC COMMITTEE

UNITED STATES CONGRESS

JULY 28, 1980
Mr. Chairman, Members of the Committee:

The subject of these hearings—state and local governmental finance and the changing national economy—is one of extreme importance to the future of this country. Inevitably, the hearings pose two issues:

1) What to do about state and local government finance, given striking short- and also long-run changes in the nation's economy?

2) What to do about the American economy?

My experience convinces me that the two questions are inseparable. Congress deserves considerable credit for authorizing a study which links the two, as does Dr. Bahl for carefully and articulately tracing the linkages in the study released today.

Dr. Bahl’s study call for a “National Urban Policy”. I second that call and urge the simultaneous formulation of a compatible "National Economic Policy". We cannot hope to attain the first without addressing the second. Furthermore, it is increasingly important to recognize that a meaningful national economic policy is also one which addresses regional differences explicitly.

The combination of inflation and recession which marks our national economy has a general impact on all state and local

THE FRAGILE FISCAL BASE OF SO MANY MAJOR CITIES OF THE DECLINING NORTHERN TIER IS A MIRROR AND CONSEQUENCE OF THE FRAGILE INDUSTRIAL FOUNDATION OF THE REGION’S ECONOMY. THIS IS A PRODUCT OF HISTORY, DEMOGRAPHIC SHIFTS, INCENTIVES INHERENT IN PAST FEDERAL POLICY AND TRENDS IN CAPITAL INVESTMENT AND IS MOST RECENTLY EXACERBATED BY THE ENERGY CRISIS.

IT IS A CRUEL FATE THAT THE REGION OF THE COUNTRY WHICH SUFFERS A GENERAL LONG-TERM ECONOMIC DECLINE IS ALSO POOR IN OIL AND, SUPERIMPOSED UPON THE BASIC PROBLEMS OF ECONOMIC DECLINE AND THE DIRECT DIFFERENTIAL COSTS OF MEETING ENERGY NEEDS (DUE TO CLIMATIC DIFFERENCES ALONE), WE NOW HAVE A STATE REVENUE "BONUS" AWARDED TO THE OIL RICH STATES BY VIRTUE OF OIL PRICE DECONTROL. FROM 1980 TO 1990 OIL PRODUCING STATES LIKE ALASKA, TEXAS, CALIFORNIA AND LOUISIANA WILL COLLECT INCREASED TAX REVENUES AMOUNTING TO $115 BILLION. THESE STATES CAN USE THEIR VAST REVENUES TO LOWER OTHER TAXES, INCREASE SERVICES, ATTRACT INDUSTRY BY ALMOST UNLIMITED MEANS; THEIR ECONOMIES
AND THE ECONOMIES OF SURROUNDING STATES WILL GET SIGNIFICANT BOOSTS. LIKE A DOMESTIC VERSION OF THE THIRD WORLD, THE NORTHEAST AND MIDWEST, IMPORTERS OF FUEL, ALREADY IN FINANCIAL DIFFICULTIES AND NEEDY FOR ADDITIONAL FEDERAL ASSISTANCE, WILL BEAR THE BURDEN, CREATING GREATER RISK OF FURTHER SOCIAL AND ECONOMIC DISTRESS. I DO NOT SAY THIS CRITICALLY OR FOR THE PURPOSE OF STARTING A REGIONAL WAR. I MERELY NOTE A FACT OF LIFE WHICH IS NOT GOING TO GO AWAY AND WHICH WILL GET PROGRESSIVELY MORE AND MORE ACUTE. NO ONE WILL ULTIMATELY BENEFIT FROM THIS; EVEN THE U. S. IS TOO SMALL TO PERMIT ONE HALF TO BECOME A SLUM WHILE THE OTHER HALF THRIVES.

IT IS SHORT-SIGHTED AND WRONG TO BELIEVE THAT STATE AND LOCAL GOVERNMENTS CAN DEAL WITH THESE PROBLEMS FROM THEIR OWN RESOURCE BASE. NATIONAL ACTION IS REQUIRED.

IN NEW YORK CITY, OUR EXPERIENCE OVER THE LAST FIVE YEARS PROVIDES INSIGHTS INTO WHAT IS POSSIBLE AND DESIRABLE TO EXPECT STATE AND LOCAL GOVERNMENTS IN DECLINING ECONOMIES TO DO FOR THEMSELVES AND WHAT MUST BE DONE AT THE NATIONAL LEVEL. NEW YORK CITY GREATLY IMPROVED ITS FINANCIAL POSITION BETWEEN 1975 AND 1980; AND THIS DID NOT COME ABOUT BY THE WAVE OF A MAGIC WAND. IT REQUIRED, PRINCIPALLY: CRISIS CONDITIONS AUGURING SUFFICIENTLY OMINOUS PROSPECTS TO CONVINCE THE CITY, MUNICIPAL WORKERS, BUSINESSES, THE STATE AND, FINALLY THE FEDERAL GOVERNMENT THAT THEY HAD NO ALTERNATIVE BUT TO DEAL REALISTICALLY WITH THE PROBLEM; A WORKING PARTNERSHIP AMONG ALL PARTIES; AND, THEN, REAL SACRIFICES AND CONTRIBUTIONS FROM EVERYONE;
Municipal workers contributed wage deferrals and lower than inflation rate wage agreements;

Cutbacks in services and sizeable workforce reductions;

Banks sacrificed profits in granting the City stretch-outs on loans and interest rate reductions;

The State contributed its moral obligation to interim financing, assumed $750 million of direct loans; provided increased State grants and other assistance; the State also devised the basic financial rescue and "watch-dog" mechanisms in the Municipal Assistance Corporation (MAC) and the Financial Control Board.

The residents of New York City endured higher transit fares, tuition for the first time at City University, and the general impact of real municipal service cuts.

Finally, the Federal government contributed the loan guarantees.

And yet, after five years and all this effort, we face a budget gap in the next fiscal year of over $1 billion and no letup in sight. Considerable tax increases coupled with further layoffs and service reductions will be needed to close this gap since additional
state and federal aid seem unrealistic. And then what? Then, in 1982, we will have to face another labor contract, which will cost at a minimum another $1 billion over two years and we will start on another round of tax increases and service cutbacks. For New York City, at least, it is worse than retrenchment; it is a gradual but seemingly endless program of self-evisceration.

It seems to me inescapable, looking at our own financial position that New York City and New York State are about to face once more an economic emergency of sizeable dimension and indefinite duration.

I make these points to illustrate the utter futility for certain of our cities to try to cope with fundamental structural imbalances in a period of inflation and recession. The situation of New York City may be extreme because of welfare and medicaid costs which crush the City's budget under a $1 billion burden, but, fundamentally, Chicago, Detroit, Philadelphia and Washington D.C. are no better off. Urban America is a meaningless term. Half of this country is prosperous and the other half decaying, with a domestic arc of crisis and decay stretching from Baltimore to Chicago.

Moreover, this process of decay cannot be isolated in the cities. Where urban centers struggle with automatic "budget gaps" fueled by revenue losses due to recession and long run economic decline, and by high rates of inflation on the cost side, the corresponding states cannot be far behind. New York State provided the
critical, first instance safety net for New York City in its fiscal crisis in 1975. New York State will face its own deficit in 1982 and cannot shoulder significant further burdens. We cannot assume that the relevant states will be capable of support as other cities experience severe fiscal difficulties.

The local actions which we are capable of taking—increased taxes and service reductions—intensify the downward spiral. Local taxes are inflationary and counterproductive. They add to the incentives for migration of people and investment to more favored areas. Deep service reductions have the same effect in the long run.

In the absence of some effective national action, State and local governments of the urbanized Northeast and Midwest face continued economic decline and stringent public sector "retrenchment" for the immediate and longer-term future. This creates a continuous downward spiral.

In my judgement what is needed is first of all a recognition that different actions are needed for different regions. Once that is established I would recommend a program that would keep the Northeast and the Midwest viable.

The most important single thing the Federal Government can do to assist states and municipalities in fiscal difficulty is to begin solving the basic problems we are now encountering in the national
ECONOMY: NOT ONLY THE GENERAL PROBLEMS OF INFLATION, DECLINING COMPETITIVENESS IN INTERNATIONAL MARKETS, ENERGY AND RECESSION BUT ALSO THE UNDERLYING STRUCTURAL PROBLEMS, MANY OF WHICH ARE REGIONAL IN ORIGIN OR EFFECT.

SOLVING THESE NATIONAL ECONOMIC PROBLEMS WILL NOT BE EASY. I BELIEVE IT REQUIRES MEASURES, LIKE A STIFF GASOLINE TAX TO REDUCE ENERGY CONSUMPTION AND CREATE SOME OF THE REVENUES NEEDED FOR POSITIVE ECONOMIC ACTION, WHICH HAVE NOT YET ATTAINED POLITICAL SUPPORT. BUT THE GREATER DANGER IN FOCUSING ON NATIONAL PROBLEMS IS THE TEMPTATION TO ADOPT ACROSS-THE-BOARD MEASURES—LIKE A GENERAL TAX CUT—IN A MISTAKEN ATTEMPT TO BE "EVEN HANDED."

ACROSS THE BOARD STIMULUS MAY ACTUALLY ACCELERATE THE TREND OF BUSINESS AWAY FROM OUR DEPRESSED AREAS. GIVEN THE REAL REGIONAL DIFFERENCES I HAVE MENTIONED, ANY EXPENDITURE OF NATIONAL RESOURCES HAS TO BE DELIBERATELY TARGETED. THIS APPLIES EQUALLY TO DIRECT EXPENDITURES OF FEDERAL DOLLARS AS WELL AS TO THE ECONOMIC STIMULATION THAT A TAX CUT IS DESIGNED TO PRODUCE.
In any specific program aimed at urban revitalization, I would include:

1) Changes in Federal formulas, mainly welfare and medicaid, so as to spread the burden of those costs to reflect need as well as ability to pay. In addition, any programs which are mandated by Federal law and which add costs to already overburdened State and local budgets must be accompanied by sufficient federal funds to carry out the mandate.

2) Exploration of programs to encourage local tax reduction with Federal participation. This could be done by having the Federal Government assume additional local costs in an amount equal to the fiscal dividend to the Federal budget created by local tax reduction. Local taxes are inflationary and a disincentive to business. Having the Federal Government support local tax reduction by reinvesting its fiscal benefits would give target stimulus at no budgetary cost.

3) The immediate creation of an institution modeled after the Reconstruction Finance Corporation of the 1930's to provide a safety net and capital infusion for certain industries, financial institutions, and municipalities in serious difficulties; like all safety nets, it should be initiated before further disasters and not afterwards. Too many large corporations are now seriously over-leveraged; too many financial institutions are not nearly as strong
AS THEY SHOULD BE, TOO MANY CITIES IN DIRE STRAITS.

THE RECONSTRUCTION OF OUR OLDER CITIES WILL HAVE TO TAKE PLACE ALONGSIDE THE RESTRUCTURING OF OUR BASIC INDUSTRIES. LIKE SIAMESE TWINS THE DISEASE OF ONE INEVITABLY INFECTS THE OTHER. AS THE INDUSTRIAL EFFORT NEEDED OVER THE NEXT TWO DECADES BEGINS TAKE HOLD, A DELIBERATE EFFORT WILL HAVE TO BE MADE TO FUNNEL PRIVATE ACTIVITY INTO THE URBAN AREAS. A GENUINE PARTNERSHIP BETWEEN BUSINESS-LABOR AND GOVERNMENT MUST CREATE THE INDUSTRIAL PARKS WHERE PRIVATE BUSINESS WILL FIND IT ECONOMICAL TO PRODUCE (INITIALLY ON A GOVERNMENT-SUBSIDIZED BASIS), WHERE THE LABOR UNIONS WILL COMMIT TO ENCOURAGE MINORITY ENTRY AND TRAINING, WHERE THE COMMUNITY LEADERSHIP WILL INVOLVE ITSELF AND THE LOCAL SCHOOL SYSTEM TO BECOME PART OF A PROCESS. A YOUNG BLACK OR HISPANIC MUST BE MADE TO FEEL THAT HE HAS A FUTURE IF HE STAYS IN SCHOOL, OFF THE STREETS AND OUT OF TROUBLE.

THE RFC CAN AND SHOULD PLAY A VITAL ROLE IN THIS PROCESS BOTH IN THE FINANCING AND RESTRUCTURING OF BASIC INDUSTRY AND IN HELPING OUR OLDER CITIES REBUILD THEIR PHYSICAL PLANTS AND MAINTAIN MINIMUM LEVELS OF VITAL SERVICES IN TIMES OF TROUBLE.

I AM NOT COMPETENT TO SPEAK FOR OTHER PARTS OF THE COUNTRY, BUT I DO KNOW THIS, JUST AS THE WESTERN WORLD IS BEING BANKRUPTED BY A $200 BILLION PER ANNUM TAX REPRESENTED BY OUR PAYMENTS TO OPEC,
SO THIS COUNTRY WILL TEAR ITSELF APART BY INTERNAL SHIFTS IN WEALTH FULLY AS DRAMATIC. IN THAT CONNECTION, HOWEVER, WE DO HAVE AN ADVANTAGE: WE ARE NEGOTIATING WITH OURSELVES AND WE ARE ALL AMERICANS.

FOR US IN THE NORTHEAST IT IS FUTILE TO TRY TO COPE WITH LONG-TERM STRUCTURAL PROBLEMS BY TAKING SHORT-TERM ACTIONS THAT WILL ONLY EXACERBATE OUR ULTIMATE SITUATION. INCREASED TAXES, LAYOFFS AND REDUCED SERVICES IN A TIME OF INFLATIONARY RECESSION WILL ACCENTUATE OUR REGIONAL DOWNTURN AND DRIVE MORE AND MORE TAXPAYERS AWAY. THERE WILL COME A POINT WHEN THE HEMORRHAGE IS NOT REVERSIBLE.

IT IS FOR THAT REASON THAT I HAVE FOR THE LAST TWO YEARS CALLED FOR A TEMPORARY WAGE/PRICE FREEZE THAT, AT THE VERY LEAST, WOULD ENABLE US TO DEFER WAGE INCREASES THAT, EVEN THOUGH REASONABLE BY CURRENT STANDARDS, ARE CLEARLY BEYOND OUR CAPACITY TO PAY. SUCH A FREEZE SHOULD STAY IN PLACE UNTIL CHANGES IN NATIONAL POLICIES ARE MADE THAT WOULD REDRESS OUR STRUCTURAL IMBALANCES. SHORT OF SUCH ACTION AT THE FEDERAL LEVEL, WE WILL AGAIN BE CALLED UPON TO CONSIDER EMERGENCY ACTION IN THE CITY AND STATE OF THE TYPE WE INSTITUTED IN 1975 AT GREAT PAIN AND GREAT COST TO ALL OUR CITIZENS.

THERE ARE UNFORTUNATELY NO EASY OR PAINLESS ANSWERS. IT IS EVEN POSSIBLE THAT THERE ARE NO ANSWERS AT ALL. ENORMOUS AMOUNTS OF CAPITAL WILL BE NEEDED TO REBUILD OUR OLDER INDUSTRIES AND CITIES, PROVIDE ALTERNATIVE SOURCES OF ENERGY, AND FUEL THE STEADY GROWTH OF OUR ECONOMY. THIS WILL REQUIRE SOME SHIFTS FROM CONSUMPTION TO
production and new sources of revenues. A stiff gasoline tax would
clearly provide the revenues as well as helping the dollar by
reducing oil imports. It may not be popular but sooner or later it
will have to happen.

Tax cuts, targeted to the areas of need and designed to
encourage productive investment, would also help create capital.
Finally, some of the capital will have to come from OPEC -- recycling
petrodollars on a long-term basis not just into bank accounts and
real estate but into new production and jobs.

For us in the Northeast more of the same is slow death. We
need recognition that basic changes have to occur, that federal
intervention is required and that this is a matter of enlightened
self interest for all. Our body social and political cannot be
immunized from the spreading cancer of our older regions,
Statement of
FELIX G. ROHATYN
before the
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
of the Senate of the United States

Mr. Chairman and Distinguished Members of the Committee: I would first like to report on the status of the Four Year Debt Issuance Plan and MAC's participation in that financing package. Since that program was constructed in October, 1978, the Corporation has issued a total of $1.8 billion of its bonds—$901 million to date during fiscal year 1980. The $1.8 billion has been raised from the following sources:

  --$938 million from private placement to various financial institutions and City Pension Funds according to the terms of the November 1978 Agreement,

  --$64 million from an exchange with the New York State Insurance Fund, and

  --$847 million from public sales.

As a direct result of these financings, the City's seasonal borrowing requirements have been reduced from approximately $1.9 billion required in 1978, to approximately $650 million required during fiscal years 1979 and 1980. The short-term credit market viewed this development positively, enabling the City to sell publicly, for the first time since 1975, $275 million of its notes to meet a
portion of its 1979 seasonal financing requirements.

To date, during fiscal year 1980, the City has sold $250 million of its notes publicly, and expects to meet the balance of its 1980 seasonal requirements from public sales.

The Corporation's refundings have produced a more stable debt service structure which will permit MAC to meet any shortfall which may occur in the City's own long-term financing program. These refundings have been accomplished in a way that has reduced MAC's average interest cost for the refunded debt by over 100 basis points at a time of an unprecedented climb in the level of interest rates. The refundings have also produced approximately $250 million of net budgetary savings for the period from 1980 to 1985, ahead of the schedule committed to at the time the first Four Year Plan was developed.

With regard to the City's budget, it has been my position for a number of years, as you know, that the adoption of those stern measures which are ultimately required to achieve balance, should not be postponed until the final year of the Plan. It has seemed inadequate to me, that gaps were closed primarily
on the revenue side of the budget. A series of nonrecurring revenues, as well as revenue increases resulting from inflation, provide an insecure foundation on which to build credibly balanced budgets. Therefore, the decision of the Mayor to submit a budget, balanced according to Generally Accepted Accounting Principles, one year before it is required, is a singularly important step. It is an action for which the Mayor should be commended, for it demonstrates clearly a recognition by the City of the need to act without delay and the willingness to implement painful, but necessary, budget cuts.

This is not meant to lull us into any false sense of relief. Even with the adoption of a budget balanced according to GAAP for FY 1981, there are continuing problems which must be addressed by the City over the long term: the cost of future wage settlements with municipal employees; the likelihood of continued deficit spending by the Health and Hospitals Corporation, the Board of Education and the Transit Authority; and, the need for ever-increasing levels of Federal and State aid. Further, the City has to date failed to demonstrate the ability to minister to its own physical needs. The resources made available to it in this Four
Year Financing Plan have not yet been fully applied to those deteriorating streets, sewers, bridges and parks which require immediate attention. The City must develop the capacity to plan and execute the restoration of its physical plant.

The achievement by the City of a GAAP balanced budget now, and the prospects for repeated balanced budgets in the future, continue to be the single most important test for gaining entry into the credit markets. It is the mark of fiscal stability toward which the investment community has looked since the City's crisis began. While the City does not now have market access for its bonds, it can reasonably be expected that the adoption and implementation of a balanced budget for fiscal year 1981, and, the adoption in June, 1981 of a balanced budget for fiscal year 1982 will encourage those agencies which rate municipal bonds to recognize the progress which the City has made and assign an investment-grade rating to long-term City securities. During this period of time, the Municipal Assistance Corporation has the economic capacity to both fulfill its own part of the Four Year Debt Issuance Plan, and to issue such additional debt as may be required
by the City's capital improvement program. I am prepared to recommend to the New York State legislature that it extend MAC's authorization to issue debt beyond fiscal year 1982 for that period of two or three years required for the City to be able to fully support its own capital needs in the public credit markets. Given the volatility which currently prevails in the debt markets, and the grim outlook for the national economy, I could construct a set of events which would argue for the utilization in 1982 of a portion of the remaining Guarantees to supplement the issuance of MAC bonds.

However, given a combination of:

--- resolve on the part of elected City officials, to act decisively now, to bring the budget into balance,

--- the cooperation of those governments which reside in Albany and Washington, and

--- some measure of good fortune,

I do not anticipate returning to Washington in 1982 in search of additional assistance.
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\[ L = 9,67891 \]

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<td>42,800</td>
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(In Thousands of Dollars)

Debt Service Payment and Funding Requirements for Fiscal Year

Municipal Assistance Corporation

8/01/80 11:57
| Year | Funding | Interest | Total | Principal | |---|---|---|---|---|
| 1979 | 1,100 | 2,700 | 3,800 | 0 | 0 |
| 1980 | 1,941 | 1,410 | 3,351 | 0 | 0 |
| 1981 | 1,072 | 1,072 | 2,144 | 0 | 0 |
| 1982 | 2,731 | 2,731 | 5,462 | 0 | 0 |
| 1983 | 3,293 | 3,293 | 6,586 | 0 | 0 |
| 1984 | 4,924 | 4,924 | 9,848 | 0 | 0 |
| 1985 | 6,285 | 6,285 | 12,570 | 0 | 0 |
| 1986 | 7,480 | 7,480 | 14,960 | 0 | 0 |
| 1987 | 7,958 | 7,958 | 15,916 | 0 | 0 |
| 1988 | 7,920 | 7,920 | 15,840 | 0 | 0 |
| 1989 | 7,622 | 7,622 | 15,244 | 0 | 0 |
| 1990 | 8,563 | 8,563 | 17,126 | 0 | 0 |
| 1991 | 9,580 | 9,580 | 19,160 | 0 | 0 |

(In Thousands of Dollars)

Data Service Payment and Funding Requirements by Fiscal Year

For the City of New York

Housing Assistance Corporation
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<tr>
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<td>12,510</td>
<td>4,170</td>
<td>16,680</td>
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(In thousands of dollars)
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<th>Year</th>
<th>Total Payable (in Thousands of Dollars)</th>
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Debt Service Payment and Funding Requirements by Fiscal Year

For the City of New York

Municipal Assistance Corporation

80/12/28 12:10
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Debt Service Payment and Funding Requirements by Fiscal Year

For the City of New York

Municipal Assistance Corporation

6/30/1979
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**Note:** All amounts are in thousands of dollars.

**Purpose:** Debt Service Payment and Funding Requirements by Fiscal Year

**For:** City of New York Municipal Assistance Corporation

**Date:** 08/01/2019
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### Debt Service Payment and Fund Balance Requirements for Fiscal Year

For the City of New York

Municipal Assistance Corporation

80/01/22 1033
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**Debt Service Payment and Fund Use Requirements by Fiscal Year**

For the City of New York

Pension Assistance Corporation

80/10/29 1037
9 June 1978

Honorable John Heinz
UNITED STATES SENATE
4327 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Heinz:

You suggested Wednesday, during the hearing, that it would be useful to you if I would amplify in writing on my remarks with respect to seasonal financing versus long-term financing. I hasten to do so since the subject is both complicated and critical and the very nature of a hearing may not do it justice.

We are faced with a financing problem, pure and simple. The objective, yours and ours, is to get the City's budget back into balance and get the City back into the market for all its financing requirements. Total market access will require:

1. Budget balance;
2. Total financing requirements brought down to levels the market can absorb;
3. A demonstrated record of credit worthiness over a period of time;
4. Investment grade credit ratings;
5. Investor psychology 180 degrees away from today's skepticism.

The City of New York's financing structure is one of the largest and most complex in the world. The appropriate solution to this massive and complicated problem cannot be a cut-rate, minimum answer with no margins built into it. It must be comprehensive, carry stringent disciplines and security, but be adequate to do the job.
In my testimony I indicated my belief that continued seasonal financing might avoid bankruptcy but would not bring the City back to balance and to the market. Even this, however, could be optimistic. Avoidance of near-term bankruptcy could only be achieved, as I indicated, with commitments to some minimum amount of long-term financing from banks and unions. As you know, the only unguaranteed long-term commitments we now have consist of $1 billion from financial institutions, conditioned, among other things, on Federal guarantees being enacted. As I indicated to you Wednesday, for seasonal loans to enable us to avoid bankruptcy and carry the city for three or four years would require, at a minimum, the $1 billion commitment from the financial institutions to be available, with at least another $500 million from the union pension systems. Such commitment is not presently in place. Were it obtainable, it might be possible for MAC, although this is also by no means certain, to raise about $1 billion in the marketplace, for a total of $2.5 billion. I consider this absolutely the "best case" scenario with seasonal loans, and I will analyze its impact below.

The "worst case" scenario, however, comes first. This would involve seasonal loan legislation coupled with our inability to obtain the needed private placement commitments from the institutions and unions mentioned above. This would, in my judgement, foreclose the public market to MAC entirely and make bankruptcy inevitable in the next few months. I have no way of predicting the reaction of these institutions although I am aware of their skepticism regarding the likelihood of success under a seasonal plan. Since both banks and unions will be testifying before your committee next week, I would urge you to probe their willingness to invest under those circumstances. If their answer is negative, then, obviously, voting for seasonal loan extension is simply voting for bankruptcy.

If their answer is affirmative, or simply non-committal, I would like to come back to the "best case" scenario, i.e., institutions and unions purchase $1.5 billion MAC privately, MAC sells $1 billion publicly, for a total of $2.5 billion long-term financing. As you know, about one-half of the long-term financing called for by our $4.5 billion plan is dedicated to budget closing items (phase-out of capitalized expenses, refunding high-interest MAC Bonds, funding capital reserve funds) or debt-reducing items (bonding out State advance). Our capital program, moreover, must deal with a large back-log of needs. It follows inevitably, that however you allocate the $2 billion reduction in available financing,
9 June 1978
Honorable John Heinz
Page Three

it will result in sharp reduction of important capital pro-
grams, delay budget balance and maintain high seasonal financ-
ing requirements. It is, therefore, just as inevitable that the City will not be able to finance itself publicly at the end of such program and that further Federal credit assistance will be needed.

Furthermore, MAC, at that time, will have used up almost all of its $8.8 billion authority, and the City will have only the Federal Government to look to for long-term financing since MAC will be out of the picture.

The result will be renewed requests for long-term credit assistance in significantly larger amounts than anything being discussed today.

As I said at the beginning of my letter, this is probably one of the most complicated financing problems in the world today. It requires an appropriately sophisticated solution. Extension of the seasonal loan is an easy answer; as with most easy answers, it is also, unfortunately, the wrong answer. In this particular case, it is obviously the wrong answer. The "worst case" scenario is bankruptcy, and the "best case" scenario is failure over time.

It seems to me that the real issue to be faced here is not long-term financing versus short-term financing for the Federal Government. The Federal Government, whether it likes it or not, is now a long-term lender to New York, no matter what the terminology. The real issue should be to build into the guarantees the same safeguards, the same discipline and the same pressures encompassed by the seasonal loans to keep the City's feet to the fire in its continued reform. At the same time, you might build into the guarantees incentives for early retirement of the guaranteed debt as and when City market access in size is obtained. As I told you Wednesday, these are both technically quite feasible.

I am available to you at any time to discuss any aspect of this issue. It is crucial to us and to you. I urge you not to support a course of action which, at worst, leads to dis-
aster and, at best, leaves us worse off than when we started. Although no one can say with absolute certainty that the guarantees assure us of success, it is likely that they will since the program would achieve the prerequisites to market entry with MAC still having some reserve in case of need. The
guarantees are also cheaper, involve no cash outlay and involve no greater risk to the Federal government. It is a program worthy of your support.

Sincerely yours,

MUNICIPAL ASSISTANCE CORPORATION FOR THE CITY OF NEW YORK

Felix G. Rohatyn,
Chairman

FGR/ld

cc: Chairman William Proxmire
Members of Senate Banking Committee
TESTIMONY BY FELIX G. ROHATYN
CHAIRMAN
MUNICIPAL ASSISTANCE CORPORATION FOR THE CITY OF NEW YORK

BEFORE

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

JUNE 7, 1978
Mr. Chairman, Members of the Committee:

I will make my comments as brief as possible. I have had the privilege of testifying before this committee many times on this particular subject; this will probably be my last appearance and my views will come as no surprise to you. I would therefore rather face your criticism than your boredom, although I will try to avoid both.

Two basic issues face us today. First, does the city need, and is it entitled to, Federal credit assistance of any kind. Second, if the answer is affirmative, should this assistance be of a long or short term character.

The city needs continued credit assistance because, without it, in my judgement, there exists not only a risk but likelihood of bankruptcy. I believe this to be an unacceptable risk for reasons that I have stated here and everywhere else ad nauseam. I come down affirmatively on the proposition that the city is entitled to assistance although I will grant you that appearances sometimes would argue otherwise. The fact of the matter is that much has been accomplished over the last 3 years, the city and the state have kept their commitments to the Federal Government and I believe that they will continue to do so until our common objective is achieved: a city in true budgetary balance, financing itself independently.
My answer to the second question is just as unequivically to support the Administration proposal for up to $2 billion in long-term loan guarantees. We have, over the last 3 years functioned with seasonal loans. It was and is a program vital to our survival; it did not however, bring us back to fiscal health. During this period we have, through MAC, refinanced $6 billion of short-term debt on a long-term basis. We have placed or have commitments to purchase $2.5 billion of additional long-term debt with pension systems. Significant improvements in the budgetary area were and continue to be made with a 1975 deficit of over $2 billion reduced to a current level below $800 million. A non-existent data base has been turned into a system that now furnishes regular and reliable financial reports. The Control Board has been extended for many years to come and MAC’s borrowing authority has been lifted to close to $9 billion. And yet the city cannot even sell short-term notes.

Over the last 3 years more has been accomplished than many thought possible and yet the marketplace, the ultimate arbiter, says it is too soon. We thought we might not be back if we did what we said we would do, we were wrong.

I support the proposition that the Federal Credit role should be as limited as possible in size and as residual as possible in character. But it has to be the keystone to the financial arch to accomplish your objectives and ours.
NEVER TO HAVE TO GO THROUGH THIS EXERCISE AGAIN.

Although obviously no one can give you such assurance, I believe far and away the best chance of accomplishing this consists of a 4-year plan similar to the one we have tried to put together based on the Administration's proposal. It would consist of $6 billion of total financing, of which $4.5 billion would be long-term and $1-1/2 billion seasonal. The Federal guarantees would be limited to $1 billion as part of the original committed package, with the second billion kept on a standby basis against possible failure of future market access. (It would obviously be helpful to us if we could use the standby on a seasonal or long-term basis, as needed.) The long-term portion would be made up of a private placement of $1.5 billion MAC bonds with city pension systems and financial institutions $1.0 billion Federally guaranteed bonds with city and state pension systems, $1.0 billion MAC bonds sold publicly over 4 years, $1.0 billion of city and/or MAC bonds sold publicly in years 3 and 4, backed up by the remaining Federal guarantees. The short-term would be made up of $500 million each from banks and city pension systems of a combination MAC and city notes, with the balance coming from public sales of city notes. We are exploring the possibility of the state participating directly in the seasonal financing although legal problems relating to crossing the state's fiscal years may make this impractical.
Such a plan would result in unguaranteed commitments by the banks and the city pension systems of $1 billion each, unguaranteed commitments by insurance companies and savings banks of $500 million and guaranteed commitments by city and state pension systems of $500 million each. It would rely on public markets for the balance. The likelihood of the second billion dollars of federal guarantees being called upon would be remote, in my judgement. If the city failed in part or in toto with its attempts to re-enter the markets in years 3 and 4, MAC would still have almost $1 billion of capacity to take up the slack before any of the guarantees are called upon. However, if the first billion dollars of committed guarantees is the keystone of the arch, the second billion, on standby, is the safety net to protect the whole enterprise. I do not believe the second billion is likely to be called upon, mostly because it is there. However, recessions do occur, money markets do get tight and the unforeseen can happen. A few weeks ago a world famous aerialist walked a high wire without a net; a gust of wind blew him to his death. Whatever happens here, the city will be walking a financial high wire for some time to come. We would rather not do so without a safety net.

The practical result of such a plan would be to limit the likely Federal financing role to slightly over 15% of the total financing required. This is clearly both a
residual and a limited role. It is less than half the present size of Federal credits but would constitute the vital element around which the financing would coalesce.

It is worth noting that the original Federal Seasonal Loan of 1975 of $2.3 billion represented almost 50% of the total financing package then put in place, with $2.5 billion coming from commitments by the pension systems. The role of the federal government, in the present case, is clearly and sharply reduced, both in size and in character.

Let me hasten to emphasize that a financial plan is only a combination of numbers adding up to a total. We believe our plan to be reasonable, to leave margins for error in the event of contingencies, to have a chance of being attained on the basis of commitments obtained or expected, and to accomplish what we set out to do. It is neither the ultimate nor the only plan because there is no such thing. One can argue about the contributions of this or that group, the relationships among the groups, the amounts of long and short-term financing needed. As in Rashomon, truth is many-faceted. Our job, at MAC, is to come up with a workable model, which we believe we have done. Any change, improvement, variation that does the
JOB BETTER OR MORE SWIFTLY WILL HAVE OUR ENTHUSIASTIC SUPPORT
AND COOPERATION.

LAST BUT NOT LEAST ARE THE QUESTIONS: WHY LONG-TERM
FINANCING INSTEAD OF SEASONAL; AND THE ISSUE OF PRECEDENT IN
FEDERAL/CITY RELATIONSHIPS.

A CONTINUATION OF SEASONAL FINANCING WILL AVOID BANK-
RUPTCY BUT WILL MOST PROBABLY NOT PERMIT BUDGET BALANCE, OR
LONG-TERM FUNDING OF REMAINING PAST DEFICITS, OR BRINGING
TOTAL FINANCING REQUIREMENTS DOWN TO MANAGEABLE LEVELS WITHIN
THE TIME FRAME INVOLVED. IT WOULD THEREFORE PROBABLY NOT
REOPEN MARKET ACCESS IN TIME AND WOULD REQUIRE THE CITY TO
RETURN TO THE CONGRESS FOR FURTHER EXTENSIONS. AS A RESULT
THE FEDERAL GOVERNMENT MIGHT ACTUALLY HAVE A LARGER AND
LONGER FINANCIAL INVOLVEMENT THAN THROUGH THE GUARANTEE ROUTE,
ESPECIALLY IF INCENTIVES ARE BUILT INTO THE GUARANTEEES TO HAVE
GUARANTEED BONDS REFUNDED AS SOON AS POSSIBLE.

ALTHOUGH IN MY JUDGEMENT, THE GUARANTEES ON THE UP-FRONT
PART OF THE PACKAGE (I.E. IN OUR CASE $1 BILLION) WOULD HAVE
TO RUN THE ENTIRE 15-YEAR LIFE OF THE BONDS, THE GUARANTEES
ON THE STANDBY COULD WELL BE SHORTER, THUS CREATING DISINCENTIVE
TO THEIR USE. INSOFAR AS EARLY REDEMPTION OF THE $1 BILLION
OF COMMITTED GUARANTEED BONDS IS CONCERNED ONE COULD PROVIDE
THAT, ONCE THE CITY HAS RE-ENTERED THE MARKET, SOME PERCENTAGE
OF EACH PUBLIC SALE WOULD BE EARMARKED FOR THE EARLY RETIREMENT
OF GUARANTEED BONDS, STARTING WITH THE LATEST MATURITIES.

AS TO PRECEDENT IT WOULD SEEM TO ME THAT NOT MANY CITIES OR STATES COULD OR WOULD:

A) CREATE A CONTROL BOARD SHARPLY LIMITING HOME RULE FOR UP TO 30 YEARS.

B) CREATE A MAC TO RAISE SEVERAL BILLION DOLLARS IN DEBT WITH THE STATE'S MORAL OBLIGATION BEHIND IT.

C) HAVE THEIR EMPLOYEE PENSION SYSTEMS PURCHASE SEVERAL BILLION DOLLARS OF UNGUARANTEED OBLIGATIONS.

ANY GOVERNOR OR MAYOR WHO FOUND SUCH A PROGRAM ATTRACTIVE, EXCEPT AS THE ONLY ALTERNATIVE TO BANKRUPTCY, MIGHT ALSO THINK TEN YEARS IN LEAVENWORTH A GREAT WAY TO SPEND A VACATION. I DOUBT THERE WILL BE MANY.

I WOULD, THEREFORE URGE THE MEMBERS OF THIS COMMITTEE, AS STRONGLY AS I KNOW HOW, TO SUPPORT THE ADMINISTRATION PROPOSAL WHICH WILL ENABLE US, TOGETHER, TO FINISH WHAT, TOGETHER, WE SET OUT TO DO 3 YEARS AGO.
### Proposed $4.5 Billion Long-term Financing Plan

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### Proposed $1.5 Billion Seasonal Financing Plan

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<tr>
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### Summary of $6.0 Billion Long-term and Seasonal Financing Plan

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*Back-up: Public sales of MAC bonds and private placement of guaranteed bonds to City and State pension funds will serve as back-up to the proposed public sales of City bonds.
## SCHEDULE OF LONG-TERM INVESTMENTS
($ millions)

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<td>Private sale:</td>
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<td>.MAC Bonds</td>
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*Back-up: Public sales of MAC bonds and private placement of guaranteed bonds to City and State pension funds will serve as back-up to the proposed public sales of City bonds.

## USES OF FUNDS

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<td>1,206</td>
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United States Senate

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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NATIONWIDE COVERAGE
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
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 default. They are going to require annual submissions and, if those submissions are incorrect 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 intellectual
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
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 guarantee 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 credit, investment and or anybody's credits, whether the city can go back to the market, all depend on 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
to the bar 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 term financing 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 hereunder and not necessarily to the length of the guarantee. So
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 to 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
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 an 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.
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.
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 kinds 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
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 clearing-house 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.
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
transaction has to be *part of*
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
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 city's 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
$8.0 billion of our $8 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
selling a

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 capaci-
at that time, with the city still not being in the market beca-
se 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
$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 various 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 the 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 what the federal/short has 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
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. 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.
TESTIMONY GIVEN BY

FELIX G. ROHATYN

CHAIRMAN, MUNICIPAL ASSISTANCE CORPORATION

BEFORE

Congressional Sub-committee on Economic Stabilization

ON

March 8, 1978
Mr. Chairman, Members of the Committee:

I join the Governor in supporting the basic approach of the proposal made by the Secretary of the Treasury. The keystone of that proposal is the availability of $2 billion in Federal guarantees for New York City's long-term financing. That keystone, when firmly in place, will support a broad arch of State and City efforts which should serve as a bridge to self sufficiency.

Secretary Blumenthal was careful to leave open for negotiation and the legislative process the details of the way the guarantees would work, as well as other aspects of his plan. For example, the Administration's present view is that the City can do its own seasonal financing, and that the total amount of borrowing can be reduced from the level outlined in the City's Four Year Plan. However, the Secretary indicated he was open to further evidence on these and other points, and we will continue to have conversations with him and the other parties to develop specific legislative and financing proposals.

I would like to mention a number of the areas which will form the substance of these conversations.

First, the total amount of the financing plan. The difference between the $4.5 billion recommended by the Secretary and the $5.1 billion contained in the City plan may seem moot, since the principal issue at stake is the amount and the workings of the Federal guarantee. With a $2 billion Federal guarantee, the City should be able to finance the remainder of its long-term needs, whatever the total may be. Obviously, the precise amount of the City's financing needs over four years cannot be calculated now with precision.
The City may not be able to spend the full amount it has included in its capital program and it may generate other sources of cash to reduce its need for the State advance. However, it is desirable to have available substantially the full amount called for in the City’s plan, to insure before the first dollar is asked or ventured that the entire program can be completed. For example, it is important to know from the beginning that the $300 million State advance can be bonded out or otherwise eliminated, since this will substantially reduce the City’s need for seasonal loans and make seasonal self-sufficiency a real possibility.

I mention this point first since it emphasizes the interdependence of the entire financing plan. Without adequate long-term assistance, the City cannot do its own seasonal financing. Without seasonal financing, no long-term lender could prudently invest in City bonds.

Second, as I indicated, the only chance at self sufficiency for seasonal financing is a substantial reduction in the seasonal needs, probably to $1 billion or less. This can be accomplished by bonding out the State advance and by other actions which the City can take.

Once the amount of borrowing is reduced, the City can approach the market with City notes, and we also are working on a plan for MAC notes. However, the City cannot rely totally on the market next year or, perhaps, for several years. Accordingly, to be safe, we need precommitments of between $750 million and $1 billion from local banks and State and City pension funds. Since these will be the same parties we will have to ask for long-term commitments, we cannot be sure they will be willing or able to participate in seasonal financing.
Therefore, we believe at this point that the City needs a standby Federal commitment for seasonal financing. I use the word "standby" in this case deliberately: to the extent the City can secure seasonal financing from other sources, it will not draw on the Federal facility, and it is possible the Federal backup will never be used. This standby procedure is possible in the case of seasonal financing because the City's seasonal needs can be reduced to manageable proportions.

This brings me logically to the third point, which is that a standby for seasonal financing should be coupled with a firm commitment to long-term assistance. While the City's need for seasonal financing can be reduced to an amount the City may be able to manage the needs for long-term financing over the next four years are so large and the available lenders so few that the City must know from the beginning when and how it will use the Federal guarantees.

As I mentioned, we believe the City's long-term needs are close to $5 billion. Even with $2 billion in guaranteed loans firmly in place, the remaining $3 billion is still a big push, especially if the City is also expected to do its own seasonal financing. We believe the City can and should obtain advance commitments from City and State pension funds to purchase $2 billion of guaranteed bonds on a firm schedule, roughly equal amounts over four years. The balance, which will be made up of unguaranteed MAC bonds and unguaranteed City bonds, will require a minimum commitment of $1 billion from the banks, savings banks, insurance companies and possibly, City pension funds, leaving $2 billion to be done in the public market. With guaranteed investments made early, and with a new financial monitor in place, we believe this kind of market access is possible. We would plan to sell about $1.25 - 1.50 of MAC bonds and from $500 to $750 million of City bonds.
Again, with the remainder of the plan firmly in place, I believe we will be able to market these bonds—about $400 to $500 million each year—without unreasonable strain and with increasing market access for the City's own bonds.

This steady pace in the market, with the gradual and carefully timed re-entry of the City itself, is a key element of the plan.

To maintain this steady pace, we must be able to count on the firm, scheduled use of the Federal guarantees in specified amounts at specified times.

Other issues concerning the guarantee to be worked out. For example, we are open to discussion concerning the creation of a capital reserve fund or the use of revenue sharing as a form of security. However, we ask you to be mindful of limiting the credit risk to the State, so as not to impair the State's ability to raise between $3 and $4 billion each year in seasonal financing as well as $2 billion in long-term requirements for the State and its agencies.

Finally, I want to mention some of the other issues which remain to be resolved, to indicate how complicated this program is, and how much remains to be worked out. For example, both guaranteed and unguaranteed City bonds will require an extension of the Emergency Financial Control Board or the creation of some other institution with similar composition and function. In addition, City bonds will require the development and enactment of a new series of financial conditions, such as limitations on short-term debt, the build-up of a reserve fund, and a number of other protections to assure the purchaser that once the City budget is in true balance it will stay in balance for the life of the bond. All of these matters, including creation of the financial monitor, should be completed before the first guaranteed bonds are sold.
The new fiscal monitor and other terms of a new City bond will require State legislation. State legislation also is required to increase MAC's borrowing authority and permit its bond proceeds to be used for the purposes contemplated in the City's plan. Also we will have to determine whether the Federal guarantee will attach directly to a City bond or whether it will be administered through MAC or some other State agency created for this purpose. There are legal and financial advantages and disadvantages to each of these alternatives; our current thinking favors the use of a new kind of MAC bond or perhaps a new State agency.

The number and complexity of these issues indicate how much remains to be done. The President's support of long-term guarantees gets us off to a good start, but the rest of the way may be the most difficult. I know the process of negotiation and legislation tends to pare things down, to reduce the cost and exposure of the parties that have the most leverage. There will be a strong temptation to make optimistic assumptions to limit the federal involvement, and to maximize the demands on the City and its local institutions. But I want to close by emphasizing something I have said to this Committee before, that it is as important to the lender as it is to the borrower that the loan be big enough and long enough to do the job. When it is finished, this plan should have some margin in it, some room for error that may not be needed, but that won't make failure the price of miscalculation.

One other matter which is not a part of the financing program but which is obviously related to it is the current negotiation with the City's unions for new contracts. MAC will review the outcome of these negotiations as a part of its continuing review of the City's budget, but is not otherwise directly
involved. Still, the form of the new fiscal monitor will influence the outcome of the contract talks, and the outcome of the negotiations will influence the City's ability to finance itself. I am convinced that a major strike will be harmful to the City's ability to obtain financing, harmful to management and labor, and harmful, most of all, to the City itself.

To avoid a strike will take real statesmanship on both sides, which means an absence of rhetoric and a willingness to accept facts as they are. One fact is that labor should receive some modest increase. Another fact is that no increase can be allowed to impair the City's ability to balance its budget and deliver service, and that probably means the cost of a new contract will have to be offset by give backs real productivity improvements and personnel reductions. These are not easy facts for man to accept, but they must be accepted if we are to continue the kind of labor-management cooperation which has brought the City this far through its period of crisis.
Mr. Felix G. Rohatyn  
Chairman  
Municipal Assistance Corporation  
2 World Trade Center  
New York, New York 10047  

Dear Mr. Rohatyn:

At the conclusion of your testimony before the Economic Stabilization Subcommittee on February 21, I requested unanimous consent to get written responses to several questions. Your reply to the attached questions will be made part of the Subcommittee record.

Since we would like to have all written replies by March 6, your prompt attention will be greatly appreciated.

Sincerely,

Stewart B. McKinney, M.C.

Enclosure
QUESTIONS FOR FELIX G. ROHATYN:

1. In its report on New York City, the Senate Banking Committee indicates that the City needs $3.5 billion in long-term financing as opposed to the $5.1 billion called for in the City's Four Year Fiscal Plan. How would you respond to the Senate Committee's assertion that $3.5 billion is sufficient to prevent bankruptcy?

2. The City must negotiate labor contracts with almost all City employees this year. What would be the impact on these negotiations if Congress decided not to extend federal loan assistance to the City?

3. The City's Four Year Fiscal Plan called for a phase-out of the stock transfer tax. What will be the effect of this phase out on the revenue stream backing MAC bonds? Since MAC currently relies on the transfer tax, how will its ability to raise capital be affected?

4. With respect to the long-term financing proposals included in the City's Four Year Fiscal Plan, what leads you to believe that the City and State pension funds will be attracted to 25 year bonds that only carry a 10 year guarantee?
ADDRESS GIVEN BY

FELIX G. ROHATYN

FOR THE

HARVARD BUSINESS SCHOOL CLUB INTERNATIONAL DINNER

APRIL 5, 1978
Mr. Chairman, Mr. Rockefeller and Honored Guests

You do me a great honor. The men in whose company you put me, the previous winners of this award, beginning with David Rockefeller, are among the men I most admire. For someone who, like me, came to this country from Europe during World War II it is further affirmation that this is still the land of opportunity and for all its problems and all its frailties, without doubt the most compassionate, the most well meaning and the greatest country in the world.

It is today, nevertheless, obvious that, at every level of our society and in every aspect of our economy, we face enormous problems and challenges. Unemployment, inflation, the environment, the cities, racial relations, the dollar, the family, the work ethic all seem in various stages of disarray or breakdown. Governments, local and national, domestic or foreign, appear less and less able to cope with problems when they are still manageable requiring that they become crises in order to have the political will to face them. Henry Kissinger, in a recent address said: "It is a paradox of the contemporary world that, if we wait until these dangers become realities, we will lose the chance to do anything about them. At the moment when we still have a great scope for creativity, the facts are likely to be unclear and ambiguous. When we know all the facts, it is often too late to act. That is the dilemma of statesmanship."
Three years ago, when Gov. Carey asked me to take a few weeks off to try to keep New York out of bankruptcy, I was a liberal, Franklin Roosevelt my childhood hero, the New Deal an unparalleled intellectual achievement. I believed in Government's ability to manage, to right wrongs and make things work. I was also totally and completely ignorant of Government and its functioning. Today, my municipal virginity torn to shreds I am neither liberal nor conservative but profoundly skeptical. Government, at any level, is neither efficient nor inspiring. Inefficiency can be corrected but inspiration cannot be ordered.

There is no place for statesmanship in government today because the political cost of statesmanship is too great. Most of the meaningful decisions required from government today are unpleasant; they involve vocal, powerful, competing interests. They involve living up to over-commitments made by previous officeholders unwilling to face facts in their own time and place. The award you are bestowing on me tonight is both symbolic of the failures of government as well as pointing to an increasingly important role to be played by the private citizen and specifically by the businessman.

Kissinger's definition of statesmanship can be restated relatively simply; get the facts, make a judgement as to their meaning, don't kid yourself, act before it is too late. This is essentially what business leaders do everyday of their lives.
By and large, we have no illusions that we will be faced with
decisions which will make everybody richer, or more secure,
or happy. We also understand that there is more to business
than just profits; that there is the moral imperative for
affirmative action, social responsibility, environmental
protection. But it is all within the framework of a viable
on-going economic and social unit and with the recognition that,
for the businessman and for his company, tomorrow always comes.

Businessmen, by and large, are ready and willing to serve
government. As cabinet members and commission chairmen
presidential advisors and ambassadors, they have served the
country well. They are usually timid however, about getting
involved in "politics" and, through the media, in taking public
positions on a variety of issues. It is an understandable view;
politics is probably the cruelest form of activity known to man,
short of war and cannibalism. The ruthlessness of political
relationships, the callous disregard for a minimum level of
human kindness have to be seen to be believed. Not as cruel,
but equally risky, is the involvement with the media. There is
always the possibility of embarrassment, of misquotes, of
making people angry and attracting fire from various quarters.
There is possibly the greater danger of getting hooked on being
a public figure, of believing that your own inane statement,
because you see it in the New York Times, is all of a sudden
imbued with wisdom. However, if businessmen are to play the
role they can and should play, in a world increasingly in need
OF SANITY, THEY WILL HAVE TO COME OUT OF THE CLOSET AND DEAL WITH POLITICS AND THE PRESS. BECAUSE THIS IS WHERE IT'S AT.

IT IS NOT UNFAIR BIAS THAT GIVES BUSINESS A BAD IMAGE IN THE PRESS; IT IS BECAUSE BUSINESS AND THE PRESS DO NOT TALK TO EACH OTHER EXCEPT THROUGH INTERMEDIARIES SUCH AS V.P. FOR PUBLIC RELATIONS. THE RESENTMENT OF THE NEWSPAPERMAN TRANSLATES INTO A BAD STORY AND REINFORCES THE BUSINESSMAN IN HIS CONVICTION TO STAY ISOLATED. THE WALTZ CONTINUES.

LABOR LEADERS, FAR BETTER THAN BUSINESSMEN, UNDERSTOOD LONG AGO THAT INVOLVEMENT IN PUBLIC AFFAIRS AND A DIRECT RELATIONSHIP WITH THE MEDIA WERE A POWERFUL INSTRUMENT TO GET POLITICAL ATTENTION. THE BUSINESS LEADER WHO WISHES TO MAKE AN IMPACT HAS TO DO THE SAME THING. HIS VIEWS MAY HAVE THE WISDOM OF SOLOMON, BUT IF THEY HAVE THE EDITORIAL SUPPORT OF THE TIMES AND NEWS THEY WILL BECOME PUBLIC POLICY. THIS WAS PROVEN HERE. THE CITY OF NEW YORK, FOR YEARS, WAS CAREENING TO ITS OWN DESTRUCTION. LABOR LEADERS NEGOTIATED UNSUSTAINABLE CONTRACTS WITH CITY AND STATE POLITICIANS MORE THAN EAGER TO OBLIGE, BECAUSE THAT WAS EASY; THE FINANCIAL COMMUNITY PROVIDED CREDIT, BECAUSE THAT WAS EASY; THE ACCOUNTANTS BALANCED THE BOOKS WITH PHONY ENTRIES, BECAUSE THAT WAS EASY; THE PRESS SWALLOWED IT ALL BECAUSE THAT WAS EASY. TAXES WERE GOING UP EVERY YEAR, MORE AND MORE SHORT-TERM FINANCING WAS NEEDED, LAWS WERE PASSED WITHOUT ANY THOUGHT OF ECONOMIC IMPACT, BUSINESS AND JOBS WERE FLEEING, THE QUALITY OF LIFE WAS ERODING.
Page 5
It was written on the wall that a catastrophe was coming; it was absolutely inevitable. Yet, the political sector, alone, was unable to handle the crisis. First with the UDC, then with MAC and the EFCB private citizens, mostly from the business sector were called in to face the facts. We were able to contain the crisis by leveling with the politicians, the public, the press, Washington, the labor leadership. The labor leadership, incidentally, once convinced that we were telling them the truth was totally realistic, responsible and cooperative. This state of affairs is now obviously being subjected to its acid test. It was, however, a matter of no small moment to see Victor Gotbaum and Walter Wriston, David Rockefeller and Al Shanker around the Board table of Citibank agreeing on common programs of welfare reforms and tax reductions.

More than anything else, however, the influence that the private members of MAC and the EFCB had on the political process was due to the public support we gained as a result of a supportive press. Early on we made a fundamental decision to be totally candid with the press; it was a decision that entailed risk since we were continuously teetering on the brink of bankruptcy. The press, however, once it understood what we were trying to do and why, treated us with utmost fairness, gave us unflagging support and created the climate in which political leaders could do difficult and painful things. Not only could they do difficult things, but it also turned out to be good politics. I would venture
to say that Gov. Carey's popularity never stood so high as after that long summer and fall of 1975 when, together with us, he led the fight against bankruptcy.

The situation in the country today is not so different from the City's situation 10 years ago. We have the talent, the muscle, the wealth, the technology to solve all of our problems and provide for all of our citizens. But the impotence of the political structure and the incompetence of the bureaucracy turn every problem into an insurmountable mountain. Government today is like the outfielder who turns every routine fly ball into a circus catch.

Statesmanship today must come from the private sector since it seems incapable of flourishing in government. Private citizens, in their voting patterns, regularly exhibit more common sense than their leaders. In California, the voters recognized that nuclear power was a necessity if they were going to have industry in the future. In France, they recognized that Eurocommunism was plain old communism and rejected it. Peace in the Middle East will come through the common sense of the Israeli private citizen and voter who will take the necessary risks for peace more willingly than his leaders.

It is in this climate that the private citizen and, more particularly, the business leader can play a vital role if he is willing to take the risks. I say risks because it is obvious that when you venture into the public arena you are fair
game for a lot of headhunters. But the impact can be enormous and, especially when, as in the case of MAC or the EFCB, the impact is on one’s community, the satisfactions are extraordinary.

Political leaders today need more help than ever before. Some of them even know it. Most of them are faced with enormously complicated problems way beyond anything they were prepared for by prior experience. They are, by and large, nice people, enormously hard working, engaged in an occupation where the line between the real and the perceived, the necessary compromise and the cheap expedient is exceedingly fine. The business leader, in structures such as MAC, of which there will be more and more, can be of enormous help. If he is unafraid of politics, but without political ambition himself, he will have public support and can make his greatest contribution by helping the political leaders to become statesmen. The politician, every day, has to reconcile the hard realities of the moment with the impossible promises he and his predecessors made in the past. On taxes, on services, on labor costs, on jobs. Everywhere he wants peace, he wants to be loved, he wants to make everyone happy, he wants to be reelected. So did Neville Chamberlain. We can, however, help them to try to become Winston Churchills.

I thank you for this award. Through me you are bestowing it on the many, many business leaders who have been involved in the City crisis for years. I know that many of you are and
will continue to be involved. To me as I near the end of my term as Chairman of MAC, I look back on an experience I shall never forget and which has profoundly changed my life.

Awards such as this, excitement, intellectual challenge, public recognition, all those things are rewarding; what is most rewarding of all, however, is the truck driver who leans out of his cab and shouts: "Hey, Big Mac, you're doin' good."

Thank you
February 23, 1978

Gentlemen:

The attached table(s) may be included in Secretary Blumenthal's testimony on March 2 regarding further Federal financial assistance to New York City. I would appreciate your reviewing them for accuracy and receiving your comments by the close of business on Monday, February 27, 1978.

Kit Taylor, Director, Office of New York Finance, will call you then to get them.

Sincerely,

Roger C. Altman

Mr. Jack Biegel
Mr. Eugene Keiling
Mr. Robert Nogado
Mr. Jim Brigham
# Summary of Municipal Assistance Corporation Financing for New York City Fiscal Years 1976-1978

## Fiscal 1976

### Public

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<tr>
<th>Bond Type</th>
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<td>Second Resolution Bonds (Exchange Offers)</td>
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## Fiscal 1977

### Public

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<td>Second Resolution Bonds (Exchange Offers)</td>
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## Fiscal 1978

### Public

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<tr>
<td>Second Resolution Bonds</td>
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### Private

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<td>$619</td>
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## Summary

MAC Debt Outstanding December 31, 1977

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<td>Second Resolution Bonds</td>
<td>2,997.7</td>
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<td>$5,185.3</td>
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TESTIMONY GIVEN BY
FELIX G. ROHATYN
CHAIRMAN, MUNICIPAL ASSISTANCE CORPORATION

BEFORE
Congressional sub-committee on economic stabilization

ON
FEBRUARY 21, 1973
Mr. Chairman:

Comptroller Goldin and I will address ourselves to slightly different, although complementary and undoubtedly overlapping aspects of the current debate. In my testimony last December, both before this committee and before the Senate Banking Committee, I tried to make the following points with respect to a New York City financing plan:

A) That it is as important to a lender as it is to a borrower to provide the appropriate amount and type of financing, since both borrower and lender are tied to the same umbilical cord.

B) That the large amount of financing required under any New York City plan, from banks, unions, public markets etc., can only be obtained as part of a plan which promises to provide a permanent resolution to the City's endless budget and financing problems. Absent such promise, no prudent man, trustee, bank director, public investor would be likely to commit any significant funds.

C) That in order to have the prospect of such a solution, true recurring budget balance must be achieved while the City's financing needs are reduced and brought into balance with the market's ability to handle them. We must always bear in mind that a solution, in order to be lasting, requires easy, continued, unforced access to the national long and
short-term bond markets by the City. Markets cannot be force-fed.

We had, City and MAC, recommended a plan involving total long-term financing of about $5 billion. As a result, 4 years hence, the City, with a then balanced budget, would have total annual financing requirements of less than $2 billion for both seasonal and capital requirements. These would be well within the market’s ability to absorb. An integral part of the plan consists of long-term Federal loans or guarantees in the amount of $2.25 billion; these are required due to the fact that MAC, at best, has $2.5 to $3.0 billion of additional borrowing power and the City, currently, has no direct access to the market.

The Senate Banking Committee has recommended a series of City and State actions designed to assure the City’s credit-worthiness. These include establishment of a long-term fiscal monitor, increasing MAC’s borrowing authority, accelerating the phaseout of capitalized expense items, city-wide labor agreements and increasing State aid to the City. We at MAC totally agree that these steps are necessary and desirable to make the City credit-worthy. We have long supported these positions which, I believe, the City has also endorsed.

The Senate Banking Committee acknowledges that these steps will take time; even under the Committee’s schedule the budget will not be truly balanced for four years. The Committee assumes, however, that the initiation of these steps will suffice to make the City self-sufficient with respect to credit. This is where we disagree.
The Senate Banking Committee has recommended a plan involving in the aggregate $3.5 billion of long-term financing and $1.8 billion of seasonal financing, with no further Federal participation. The brunt of the long-term financing would be borne by the City Pension Systems; the main part of the seasonal financing by the State Pension Systems and the Banks.

We believe this aspect of the plan to be unworkable. The Senate Banking Committee plan has the appearance of plausability by cutting back long-term financing requirements by $1.6 billion. Instead of strengthening the plan, however, this only makes it weaker and less likely to succeed. Failure to bond out the State advance maintains high levels of seasonal financing as well as the fiction that all past deficits have been funded; failure to finance MAC capital reserve funds and to refinance high interest/short maturity MAC bonds create greater budgetary deficits and therefore postpone the City's own reentry to the market; forcing the maintenance of excessive levels of City-related paper on the pension systems is poor public policy. The fact of the matter is that the City, as opposed to MAC, will not be regarded as truly credit-worthy, on the scale required nationally, until it has shown capability to truly balance its budget recurringly, as a result of its own will, combined with the discipline of the long-term monitor. This will require years.

Regardless of amounts, however, we believe that neither the financing institutions nor the union pension systems will participate in a plan devoid of continued Federal credit assistance. I do not wish to be a
PROPHET OF DOOM; PROPHETS OF DOOM, ESPECIALLY IF THEY TURN OUT TO BE
CORRECT, ARE USUALLY BLAMED FOR THE DOOM AND HAVE A DIM FUTURE THEMSELVES.
SUFFICE IT TO SAY THAT IT IS MY PERSONAL CONVICTION THAT THE SENATE
BANKING COMMITTEE PLAN CARRIES WITH IT A VERY SERIOUS RISK, IF NOT TO
SAY A LIKELIHOOD, OF CITY BANKRUPTCY.

WHY, ONE MIGHT ASK SHOULD NOT THE PENSION SYSTEMS AND THE BANKS BE, IN
EFFECT, COMPelled TO INVEST UNDER THE IMPLIED THREAT OF BANKRUPTCY? THE
ANSWER, IN MY JUDGEMENT, WILL BE THAT THE FIDUCIARY AND THE LIABILITY
FACETS OF THEIR DECISIONS WILL MORE THAN COUNTERBALANCE THE FEAR OF
BANKRUPTCY. YOU MUST BEAR IN MIND THAT, SINCE THE CRISIS OF 1975, MAJOR
LITIGATION HAS BEEN BROUGHT AGAINST THE BANKS AND PENSION SYSTEMS AND
THE SEC HAS HARSHLY CRITICIZED THE FINANCIAL INSTITUTIONS, LAWYERS AND
RATING AGENCIES INVOLVED WITH THE CITY. THE ABSENCE OF FEDERAL CREDIT
ASSISTANCE WILL, IN MY OPINION, MAKE THE RISK TOO GREAT FOR FIDUCIARIES.

FOR ANY FIDUCIARY TO INVEST $2.25 BILLION IN UNGUARANTEED CITY PAPER SEEMS
TO ME HIGHLY UNLIKELY. MAC, BY ITSELF, DOES NOT HAVE THE BORROWING
POWER TO CARRY THE CITY FOR THE 3 OR 4 YEARS, EVEN IF IT HAD PERFECT
ACCESS TO THE MARKET. THE EVENTS OF THE LAST FEW MONTHS CLEARLY LEAD TO
THE CONCLUSION THAT A RECOGNIZED LONG-TERM SOLUTION TO THE CITY SITUATION
IS NEEDED FOR MAC TO HAVE SATISFACTORY MARKET ACCESS. WITHOUT A CREDIT
BRIDGE, PROVIDED BY THE FEDERAL GOVERNMENT, THE STRUCTURE OF ANY LONG-TERM
SOLUTION IS TOO WEAK.

IN ADDITION, LET ME REMIND YOU THAT THE WORD "CREDIT" IS DERIVED FROM
the Latin "credere" or "to believe". It is faith as well as figures. The psychological impact of the Federal Government perceived as abandoning New York City cannot be overestimated. It could be, in some ways, more of a factor in dooming the plan in the view of the other participants, than anything else.

The unequivical conclusion I have reached is that without continued Federal credit assistance it is not possible to put together a workable financing plan. The risk of bankruptcy, in that event, is obviously of a very high order. As I said earlier, the world of credit is a world of faith and psychology, as well as pure figure work. For that reason, I do not wish, as Chairman of MAC, to sit here and prophecy the certainty of bankruptcy. It is not a banner to be unfurled carelessly. Suffice it to say that the risk is there, and it is most serious. The question we ask of our government is "Why run it?" What is to be gained by such a gamble? In the next few days you will examine its possible impact. On the social life of the City, in the delivery of services. On the banking systems. On the State. On the Federal Government. On the Dollar. On all of these you will not get absolute answers but again, somber warnings of risk. On perhaps the most important of all probably no one will speak: our image in the world. In the ideological competition in which we exist, world wide, a bankruptcy of New York will be viewed as a bankruptcy of the free-enterprise, capitalistic system; as proof of the impotence of our system to solve difficult, but nonetheless finite, problems. And I think that will be a correct interpretation.
THE TEST OF STATESMANSHIP IS TO PREEMPT CRISIS. TO AVOID RUNNING
HUGE RISKS FOR SMALL STAKES. THAT IS THE PRINCIPLE ON WHICH THE
INSURANCE INDUSTRY RESTS. WE HAVE PROPOSED A PLAN WHICH AVOIDS THIS
RISK AT NO COST TO THE FEDERAL GOVERNMENT. NOT ONLY CAN THE SAFEGUARDS
PRESENTLY EXISTING UNDER THE SEASONAL LOAN PLAN BE PRESERVED, THEY CAN
BE EXTENDED. THE LONG-TERM MONITOR, SUCCESSOR TO THE CONTROL BOARD,
CAN MAINTAIN THE FISCAL DISCIPLINE. THE FEDERAL CREDIT-RISK, IF ANY,
CAN BE SECURED. THE FEDERAL ROLE CAN BE CONDITIONED ON AN ENHANCED
STATE INVOLVEMENT AND ACCELERATED CITY REFORM. WE BELIEVE THE PROGRAM
WE PROPOSE TO BE AN INSURANCE POLICY FOR THE BENEFIT OF THE FEDERAL
GOVERNMENT AGAINST THE RISKS OF A CITY BANKRUPTCY WHILE PROVIDING THE
BRIDGE TO BRING THE CITY BACK TO SOLVENCY. I DON’T EVER WANT TO FIND
OUT, MR. CHAIRMAN, IF I AM RIGHT IN MY ASSESSMENT OF BANKRUPTCY. I
AM SURE NO ONE ON THIS COMMITTEE WANTS TO FIND OUT. THERE IS, LUCKILY,
NO NEED TO FIND OUT. LET US PROCEED WITH A PLAN THAT WILL NOT ONLY
AVOID BANKRUPTCY BUT HELP THE CITY TO THE ONE OBJECTIVE THAT I AM SURE
WE ALL SHARE: TO GET US OUT OF YOUR HAIR ONCE AND FOR ALL.

THANK YOU.
TESTIMONY BY FELIX ROHATYN
CHAIRMAN
MUNICIPAL ASSISTANCE CORPORATION FOR THE CITY OF NEW YORK

BEFORE
THE SUB-COMMITTEE ON ECONOMIC STABILIZATION

UNITED STATES CONGRESS

DECEMBER 16, 1977
Mr. Chairman, members of the Committee:

Governor Carey has asked me to comment on the City’s current financing situation as well as on the prospects for future financing.

I would like to divide this problem into its two quite separate and discrete components: MAC financing and City financing. These are two quite separate and distinct issues and need to be treated accordingly.

Insofar as MAC is concerned we have had an exciting and, by and large, a most successful year. We have completed the various financings relating to one billion dollars of publicly-held City notes affected by the Moratorium decision. We have also completed arrangements with the banks and unions which held the remaining $800 million of outstanding City notes. These notes were exchanged for MAC bonds as part of a complex $2.5 billion MAC refinancing and restructuring which enormously strengthened the MAC and leveled out its debt service. As a result of these transactions, the City’s budget was relieved by approximately $1 billion over the next 6 years; MAC’s bonds were given investment grade ratings by the main rating services; our total outstanding bonds increased to over $5.1 billion with an average maturity of about 14 years and interest rates of about 8%. We started the year financing at rates over 10%, continued with an exchange offer of $400 million at 9 3/4% and ended with two public offerings aggregating
$400 million at 7 1/2%. As a result, we have the economic horsepower, within the MAC's ratios and bond covenants, to raise another $2.5 - $3.00 billion on the City's behalf. Doing so, however, will require affirmative action on the part of the State Legislature, lifting our statutory debt ceiling from its present $5.8 billion to $8.8 billion and giving us a broader charter with respect to capital financing. It will also presuppose continued market access for MAC, in size and on reasonable terms. We have fought our way back from very far to have MAC accepted in the market place and restore our credit rating. However, the interest rates we are currently required to pay (7 1/2% - 8%) are still penalty rates when looking at other tax-free municipal issuers with investment-grade ratings. These rates reflect the huge volume of MAC, anticipated future offerings, and continued nervousness with respect to New York. It must be remembered that in addition to being required to provide for most, if not all, of the City's capital financing for the foreseeable future, MAC should and will refinance some of its early high interest, short maturity issues. We expect to proceed shortly on the initial stages of such a program which, in the aggregate, could amount to as much as $750 million over a period of time. The issue of market access is a critical issue for us, maybe THE critical issue, and I will revert to it. Bear in mind that MAC was originally created to refinance $3 billion of City short-term debt; we have now refinanced $5.5 billion and expect to make the same revenue stream support close to $9 billion. There is a limit to everything, even to MAC.
Insofar as City financing is concerned, the picture is quite different. As you know, an initial City note sale, scheduled for November, in the amount of $200 million, collapsed as a result of an unsatisfactory credit rating and the inability of the underwriting group to commit to the sale. This occurred even though there was little question as to the actual security of the notes. The unwillingness of the market to absorb City paper of reasonable security, short maturity and very moderate size, bodes ill for the City's ability to finance not only short-term but long-term as well. It was clear from the Moody's rating of the City notes that a variety of uncertainties still surrounding the City would continue to affect its ability to sell securities. The main items are, in no particular order of importance:

A) The ability of the City to have a recurrent, credibly balanced budget.

B) A more rapid phaseout of expense items from the capital budget to create true balance.

C) The failure of the State Legislature to increase the MAC borrowing authority, leaving the Union Pension Systems as the sole current source of capital financing.


f) The absence of an agreed-upon long-term fiscal monitor, a sine qua non for long-term city financing.

In order to briefly sketch another weakness in our financial structure, carried over from the past, you will remember that New York has two types of outstanding long-term debt; MAC and City bonds. There are outstanding about $5.5 billion of bonds in each category. The peak debt service requirements for MAC are under $600 million in any one year. On the other hand, present debt service for City bonds is about $1.3 billion annually, reflecting appalling debt management practices in the past and resulting in property tax levels at prohibitively high rates. This latter problem needs to be dealt with.

It was my judgment last year that the City should be able to market moderate amounts of short-term notes this Winter, followed by modest amounts of long-term bonds in the Spring of 1978. I also felt that an accelerated phaseout of expense items from the capital budget was important but not crucial to long-term financing, and had to be balanced against the damage to the City's economy of further service reductions caused by such an accelerated phaseout. Finally, that the issue of the long-term fiscal monitor was resolvable allowing for a return to a minimal level of political sanity following the mayoral election. It is obvious that I erred on the side of optimism on every one of these issues, even though
optimism with respect to City matters has not been my dominant trait.

Even though the City note sale, from a pure credit point of view, should have taken place, its failure means that, at the earliest, the City will do short-term, seasonal financing in the Summer of 1978. Prior conditions thereto will be the satisfactory conclusion to labor negotiations this Spring, a credibly balanced budget for 1978-9, a Federal financing program post-June 1978. Sporadic discussions with respect to a long-term monitor have taken place over the last few months among banks and unions, City and MAC with limited areas of agreement. Until the new City administration can grapple with this issue, along with many others, little further progress will be made.

Even assuming for the moment agreement on a long-term monitor, I believe the failure of the City note sale reflects a market whose skepticism with respect to any kind of City paper is extreme. One reason for that skepticism is the growing awareness that while the City's budget now complies with law, the law permits the continuation of practices which keep the budget from being truly balanced. For purposes of planning, therefore, I have to assume that, until all expenses are phased out of the capital budget, the sale of significant amounts of long-term City bonds will be difficult if not impossible.
This brings us to the issue of the City's budget for fiscal 1979 and beyond. MAC is beginning its review of the preliminary budget submitted by the City a few weeks ago. The deficit estimated by the City to be about $250 million has been estimated by others to be still higher, even before the impact of labor negotiations is factored in. To close such a gap, in addition to doubling the phaseout rate of capital expenses, without unacceptable levels of service reductions, seems rather questionable. If possible, the phaseout of capital expenses should be financed by new, presently unavailable revenues. One such source of revenue might be property taxes freed up by refinancing City bonds with short maturities and high levels of debt service. This will bring us back to the issue of market access in due course.

One last item in examining the details of our financing mosaic before looking at the totality. Each Spring the State advances $800 million to the City, to repay Federal loans, each Summer the City borrows it back from the Federal government to repay the State. This makes no sense. These $800 million loans are the last of the unfunded past deficits which needlessly balloon seasonal requirements and should be funded long, as all other past deficits have been funded. Doing so would reduce seasonal requirements to about $1 billion per annum.
Our objectives, after about two decades of fiscal and financial insanity, are to bring New York City's budget back into true balance without destroying the City's social and economic structure, and to bring the City's financing needs into balance with its ability to sell securities. The memorandum which MAC submitted to Governor Carey on this subject, and which is submitted to you herewith, estimates that to accomplish these objectives we require about $4.5 billion of long-term financing over the next 3 years, in addition to approximately $750 million of refinancing that MAC would undertake of its previously issued bonds. Completion of such a program would leave the City with a truly balanced budget and total financing requirements of about $1 billion seasonal and $1 billion long-term annually. These would be well within the capacity of the private market to absorb, under these circumstances.

Such a program, which in my judgment is the only sensible way to finish this job once and for all, requires maybe $2 - $2 1/2 billion more long-term financing than MAC can do on its own, and more, in any case, than the market is likely to absorb regardless of MAC's ability to service.

I recognize that this is not the time to discuss post-1978 Federal financing programs which, I assume, will be the subject of later hearings. However, I would like to leave you with these thoughts. It is as important to the lender as it is to the borrower to provide the appropriate amount and type of
FINANCING; BOTH LENDER AND BORROWER ARE TIED TO THE SAME UMBILICAL CORD. A SHORT-TERM LOAN THAT SHOULD HAVE BEEN LONG-TERM WILL BECOME LONG-TERM BECAUSE OF THE INABILITY OF THE BORROWER TO EXTRICATE HIMSELF IN TIME AND THE RECOGNITION OF THE LENDER THAT EXTENDING THE LOAN IS, IN THE LENDER'S OWN INTEREST, PREFERABLE TO BANKRUPTCY. MOST CREDITS BY U.S. BANKS TO UNDERDEVELOPED COUNTRIES HAVE GONE THROUGH THE PROCESS. ON THE OTHER HAND, THE APPROPRIATE LONG-TERM LOAN, WHICH GIVES THE BORROWER BREATHING ROOM TO PUT HIS HOUSE IN ORDER, CAN TURN OUT TO BE A MUCH SHORTER INVESTMENT BY PERMITTING THE LENDER TO SELL HIS BONDS IN THE MARKET ONCE MARKET CONDITIONS HAVE STABILIZED. THE NEW YORK SITUATION, IS, IN MY JUDGMENT, MORE OF A MARKET ACCESS PROBLEM DUE TO UNIQUE VOLUME REQUIREMENTS THAN A PURE CREDIT PROBLEM. THE MORATORIUM OF 1975 WAS IMPOSED BECAUSE OF OUR INABILITY TO CONVINCE THE THEN ADMINISTRATION THAT ACQUIRING $1.7 BILLION IN LONG-TERM MAC BONDS, AS PART OF A FINANCING PACKAGE, WAS PREFERABLE TO LEGISLATED A MORATORIUM ON AN EQUIVALENT AMOUNT OF CITY NOTES. THE MARKET, THEN, WOULD NOT ABSORB THE MAC BONDS. HAD WE PREVAILED, SUCH MAC BONDS, BOUGHT BY THE TREASURY, WOULD LONG SINCE HAVE BEEN RESOLD, PROBABLY AT A PROFIT, AND THE STATE WOULD HAVE AVOIDED A LEGISLATIVE ACT WHICH WILL HAUNT IT FOR DECADES. THAT IS BUT ONE EXAMPLE OF A SITUATION WHERE LONG-TERM MARKET ASSISTANCE WAS APPROPRIATE AND WOULD HAVE BEEN IN BOTH THE LENDER'S AS WELL AS THE BORROWER'S BEST INTEREST. IT WAS NOT FORTHCOMING BECAUSE OF THEOLOGICAL, NOT ECONOMICAL, REASONING.
In closing, let me suggest that New York's economic health still has to be the foundation on which any financing will stand. New York must turn its economy around through a better business climate, tax cuts, better schools, safer streets. New York, however, cannot be expected to prosper within the framework of a national economy running $60 billion deficits, 7% unemployment, a devaluing dollar, $45 billion oil imports. One out of 8 people in the City are on welfare and nothing has happened to provide the kind of fiscal relief we had been led to expect; we cannot continue to bear that burden. We have cut services and raised taxes; we can do more, maybe, but soon our cuts will not keep up with the velocity of the shrinkage of our tax-base.

I am aware of the fact that long-term financing may be anathema to this committee, from a philosophical point of view; I believe I owe it to you as well as to ourselves to tell you that it is, in my judgment, the strongest bridge to solvency. If an extension of the seasonal loan is your ultimate decision, for years to come, New York will be back, weaker and weaker, requiring further and further extensions. If your decision is to end the program, the only result will be bankruptcy. We will all be the poorer for it.

Thank you.
Mr. Felix G. Rohatyn  
Chairman  
Municipal Assistance Corporation  
2 World Trade Center  
New York, New York 10047  

Dear Mr. Rohatyn:

The Subcommittee on Economic Stabilization is pleased that you have agreed to appear before us on February 21 to give us your views on financial prospects for New York City in the event Federal credit assistance is not extended beyond the expiration date—June 30, 1978—of the current seasonal loan program. We have asked a number of witnesses to testify before us on February 21 and 22 to give us their views on the following three questions:

1. Can the seasonal financing requirements of New York City be met by public and private resources in New York City and New York State?

2. If the City's seasonal needs are not met in fiscal year 1979, will the City be required to declare bankruptcy? If so, when?

3. What would be the effects of bankruptcy on the City and on the financial markets?

You are particularly qualified to give us your views on the first and second questions although, of course, you may speak to the other issues if you wish.

The hearings will be conducted in Room 2128, Rayburn House Office Building, Washington, D.C., beginning at 9:30 a.m. We would expect to hear from you at 9:30 a.m.
Because of time constraints, we ask that you limit your oral presentation to ten minutes, though you may submit a longer written statement for the record if you wish. We also ask that you provide us with 100 copies of your prepared remarks as much in advance of the hearing as you can so we may distribute them to the Members and the press.

With best regards,

Sincerely,

William S. Moorhead
WILLIAM S. MOORHEAD
Chairman
Mr. Felix G. Rohatyn
Chairman
Municipal Assistance Corporation
2 World Trade Center
New York, New York 10047

Dear Mr. Rohatyn:

The Subcommittee on Economic Stabilization of the House Committee on Banking, Finance and Urban Affairs has scheduled several days of hearings in February and March of this year on the fiscal and financial outlook for New York City after the expiration on June 30, 1978, of the New York City Seasonal Financing Act of 1975. I am pleased to invite you to testify before the Subcommittee on Monday, February 27, 1978, at 9:30 a.m. in Room 2128 of the Rayburn House Office Building.

The broad purposes of the hearings are fourfold: First, we want to assess New York City's financial needs, both seasonal and long term, following the expiration of the Federal seasonal loan program; second, we wish to determine to what extent the City's financial needs can be met by resources made available through City and State governmental actions and through participation in a financing program by various public and private entities; third, we wish to evaluate whether, and to what extent, additional Federal financial assistance for the City is required post-June 30, 1978; and fourth, if additional Federal assistance is required, we wish to determine how the program should be structured to insure that it will enable New York City to achieve fiscal and financial stability and regain access to the capital markets.

Your views and comments on these matters will be most helpful to the Subcommittee in its consideration of any legislative proposals for continued Federal financial assistance to New York City.
In the interest of dialogue and a greater opportunity for questioning by the Members of the Subcommittee, we ask that you limit any oral presentation you may wish to make to about ten minutes, although you may submit a statement of greater length if you so desire.

In accordance with Committee rules, please deliver 100 copies of your prepared remarks to Edwin W. Webber, Staff Director, Room 2220, Rayburn House Office Building, by noon, Saturday, February 25.

If you have need for further information, please have your staff call Ruth Wallick of the Subcommittee staff at (202) 225-7810.

With best regards,

Sincerely,

Bill

WILLIAM S. MOORHEAD
Chairman
TESTIMONY BY FELIX ROHATYN

CHAIRMAN

MUNICIPAL ASSISTANCE CORPORATION FOR THE CITY OF NEW YORK

BEFORE

THE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

DECEMBER 14, 1977
Mr. Chairman, members of the Committee:

Governor Carey has asked me to comment on the City's current financing situation as well as on the prospects for future financing.

Once again I would like to divide this problem into its two quite separate and discrete components: MAC financing and City financing. These are two quite separate and distinct issues and need to be treated accordingly.

Insofar as MAC is concerned we have had an exciting and, by and large, a most successful year. Since our last appearance before this committee we have completed the various financings relating to one billion dollars of publicly held City notes affected by the Moratorium decision. We have also completed arrangements with the banks and unions which held the remaining $800 million of outstanding City notes. These notes were exchanged for MAC bonds as part of a complex $2.5 billion MAC refinancing and restructuring which enormously strengthened the MAC and leveled out its debt service. As a result of these transactions, the City's budget was relieved by approximately $1 billion over the next 6 years; MAC's bonds were given investment grade ratings by the main rating services; our total outstanding bonds increased to over $5.1 billion with an average maturity of about 14 years and interest rates of about 8%. We started the year financing at rates over 10%, continued with an exchange offer of $400 million at 9 3/4%, and ended with two public offerings aggregating $400 million at 7 1/2%. As a result, we have the economic horsepower, within the MAC's ratios and bond covenants, to raise another $2.5 - $3.0 billion on the City's behalf. Doing so, however, will require affirmative action on the part of the State Legislature, lifting our statutory debt ceiling from its present $5.8 billion to $8.8 billion and giving us a broader charter with
respect to capital financing. It will also presuppose continued market access for MAC, in size and on reasonable terms. We have fought our way back from very far to have MAC accepted in the market place and restore our credit rating. However, the interest rates we are currently required to pay (7 1/2%-8%) are still penalty rates when looking at other tax free municipal issuers with investment-grade ratings. These rates reflect the huge volume of MAC, anticipated future offerings, and continued nervousness with respect to New York. It must be remembered that in addition to being required to provide for most, if not all, of the City's capital financing for the foreseeable future, MAC should and will refinance some of its early high interest, short maturity issues. We expect to proceed shortly on the initial stages of such a program which, in the aggregate, could amount to as much as $750 million over a period of time. The issue of market access is a critical issue for us, maybe the critical issue, and I will revert to it. Bear in mind that MAC was originally created to refinance $3 billion of City short-term debt; we have now refinanced $5.5 billion and expect to make the same revenue stream support close to $9 billion. There is a limit to everything, even to MAC.

Insofar as City financing is concerned, the picture is quite different. As you know, an initial City note sale, scheduled for November, in the amount of $200 million, collapsed as a result of an unsatisfactory credit rating and the inability of the underwriting group to commit to the sale. This occurred even though there was little question as to the actual security of the notes. The unwillingness of the market to absorb City paper of reasonable security, short maturity and very moderate size, bodes ill for the City's ability to finance not only short-term but long-term as well. It was clear from the Moody's rating of the City notes that a variety of uncertainties still surrounding the City would
continue to affect its ability to sell securities. The main items are, in no particular order of importance:

a) The ability of the City to have a recurrent, credibly balanced budget.

b) A more rapid phaseout of expense items from the capital budget to create true balance.

c) The failure of the State legislature to increase the MAC borrowing authority, leaving the Union Pension Systems as the sole current source of capital financing.


e) The labor negotiations set for the Spring of 1978

f) The absence of an agreed upon long-term fiscal monitor, a sine qua non for long-term City financing.

In order to briefly sketch another weakness in our financial structure, carried over from the past; you will remember that New York has two types of outstanding long-term debt; MAC and City bonds. There are outstanding about $5.5 billion of bonds in each category. The peak debt service requirements for MAC are under $600 million in any one year. On the other hand, present debt service for City bonds is about $1.3 billion annually, reflecting appalling debt management practices in the past and resulting in property tax levels at prohibitively high rates. This latter problem needs to be dealt with.

It was my judgement, in our last appearance before this committee last Spring, that the City should be able to market moderate amounts of short-term notes this Winter, followed by modest amounts of long-term bonds in the Spring of 1978. I also felt that an accelerated phaseout of expense items from the capital budget was important but not crucial to long-term financing, and had to be balanced
against the damage to the City's economy of further service reductions caused by such an accelerated phaseout. Finally, that the issue of the long-term fiscal monitor was resolvable allowing for a return to a minimal level of political sanity following the mayoral election. It is obvious that I erred on the side of optimism on every one of these issues, even though optimism with respect to City matters has not been my dominant trait.

Even though the City note sale, from a pure credit point of view, should have taken place, its failure means that, at the earliest, the City will do short-term, seasonal financing in the Summer of 1978. Prior conditions thereto will be the satisfactory conclusion to labor negotiations this Spring, a credibly balanced budget for 1978-9, a Federal financing program post June 1978. Sporadic discussions with respect to a long-term monitor have taken place over the last few months among banks and unions, City and MAC with limited areas of agreement. Until the new City administration can grapple with this issue, along with many others, little further progress will be made.

Even assuming for the moment agreement on a long-term monitor, I believe the failure of the City note sale reflects a market whose skepticism with respect to any kind of City paper is extreme. One reason for that skepticism is the growing awareness that while the City's budget now complies with law, the law permits the continuation of practices which keep the budget from being truly balanced. For purposes of planning, therefore, I have to assume that, until all expenses are phased out of the capital budget, the sale of significant amounts of long-term City bonds will be difficult if not impossible.
This brings us to the issue of the City's budget for fiscal 1979 and beyond. MAC is beginning its review of the preliminary budget submitted by the City a few weeks ago. The deficit estimated by the City to be about $250 million has been estimated by others to be still higher, even before the impact of labor negotiations is factored in. To close such a gap, in addition to doubling the phaseout rate of capital expenses, without unacceptable levels of service reductions, seems rather questionable. If possible, the phaseout of capital expenses should be financed by new, presently unavailable revenues. One such source of revenue might be property taxes freed up by refinancing city bonds with short maturities and high levels of debt service. This will bring us back to the issue of market access in due course.

One last item in examining the details of our financing mosaic before looking at the totality. Each Spring the State advances $800 million to the City, to repay Federal loans, each Summer the City borrows it back from the Federal government to repay the State. This makes no sense. These $800 million loans are the last of the unfunded past deficits which needlessly balloon seasonal requirements and should be funded long, as all other past deficits have been funded. Doing so would reduce seasonal requirements to about $1 billion per annum.

Our objectives, after about two decades of fiscal and financial insanity, are to bring New York City's budget back into true balance without destroying the City's social and economic structure, and to bring the City's financing needs into balance with its ability to sell securities. The memorandum which MAC submitted to Gov. Carey on this subject, and which is submitted to you herewith, estimates that to accomplish these objectives we require about $4.5 billion of
long-term financing over the next 3 years, in addition to approximately $750 million of refinancing that MAC would undertake of its previously issued bonds. Completion of such a program would leave the City with a truly balanced budget and total financing requirements of about $1 billion seasonal and $1 billion long-term annually. These would be well within the capacity of the private market to absorb, under these circumstances.

Such a program, which in my judgement is the only sensible way to finish this job once and for all, requires maybe $2 - $2½ billion more long-term financing than MAC can do on its own, and more, in any case, than the market is likely to absorb regardless of MAC's ability to service.

I recognize that this is not the time to discuss post-1978 Federal financing programs which, I assume, will be the subject of later hearings. However, I would like to leave you with these thoughts. It is as important to the lender as it is to the borrower to provide the appropriate amount and type of financing; both lender and borrower are tied to the same umbilical cord. A short-term loan that should have been long-term will become long-term because of the inability of the borrower to extricate himself in time and the recognition of the lender that extending the loan is, in the lender's own interest, preferable to bankruptcy. Most credits by U.S. Banks to underdeveloped countries have gone through the process. On the other hand, the appropriate long-term loan, which gives the borrower breathing room to put his house in order, can turn out to be a much shorter investment by permitting the lender to sell his bonds in the market once market conditions have stabilized. The New York situation, is, in my judgement, more of a market access problem due to unique volume requirements than a pure credit problem. The Moratorium of 1975 was imposed because of our inability to
convince the then Administration that acquiring $1.7 billion in long-term MAC bonds, as part of a financing package, was preferable to legislating a moratorium on an equivalent amount of City notes. The market, then, would not absorb the MAC bonds. Had we prevailed, such MAC bonds, bought by the Treasury would long since have been resold, probably at a profit, and the State would have avoided a legislative act which will haunt it for decades. That is but one example of a situation where long-term market assistance was appropriate and would have been in both the lender's as well as the borrower's best interest. It was not forthcoming because of theological, not economical, reasoning.

In closing, let me suggest that New York's economic health still has to be the foundation on which any financing will stand. New York must turn its economy around through a better business climate, tax cuts, better schools, safer streets. New York, however, cannot be expected to prosper within the framework of a national economy running $60 billion deficits, 7% unemployment, a devaluing dollar, $45 billion oil imports. One out of 8 people in the City are on welfare and nothing has happened to provide the kind of fiscal relief we had been led to expect; we cannot continue to bear that burden. We have cut services and raised taxes; we can do more, maybe, but soon our cuts will not keep up with the velocity of the shrinkage of our tax-base.

I am aware of the fact that long-term financing is anathema to this committee, from a philosophical point of view; I believe I owe it to you as well as to ourselves to tell you that it is, in my judgement, the strongest bridge to solvency. If an extension of the seasonal loan is your ultimate decision, for years to come, New York will be back, weaker and weaker, requiring further and further extensions. If your decision is to end the program, the only result will be bankruptcy. We will all be the poorer for it.

Thank you.
Mr. Felix G. Rohatyn
Chairman
Municipal Assistance Corporation
Two World Trade Center
New York, New York 10047

Dear Mr. Rohatyn:

This will confirm the change in date for the one-day oversight hearing of the Subcommittee on Economic Stabilization on the New York City Seasonal Financing Act of 1975. The hearing will be in New York City on Friday, December 16, instead of December 13, as originally planned. We are grateful for your consideration in accommodating your time to meet the demands of a changed congressional schedule.

The hearing will be held in Room 770 of the U. S. Customs House, 6 World Trade Center, starting at 9:30 a.m. We plan to hear your testimony at 9:30 a.m.

The subject and format for your testimony will be the same as I wrote you on November 23.

We look forward to hearing from you on December 16.

Sincerely,

[Signature]

WILLIAM S. MOORHEAD
Chairman
IN EARLIER LETTER TO YOU, WILL ADVISE ROOM NUMBER LATER. OTHER DETAILS ARE AS OUTLINED.

AT 9:30 A.M., TO TESTIFY ON NEW YORK CITY FINANCIAL SITUATION.

SUBCOMMITTEE ON ECONOMIC STABILIZATION ON WEDNESDAY, MARCH 8, 1978

THIS CONFIRMS TELEPHONE UNDERSTANDING YOU WILL APPEAR BEFORE

NEW YORK NY 10047

MUNICIPAL ASSISTANCE CORPORATION 2 WORLD TRADE CENTER

PMS FELIX C. RAXAITE CHAIRMAN, BLR

1200A GOVT BUILDING WASHINGTON DC 20507 202 140P EST

ICM FAXWAX WSH

VS059 (1439) (1-120274062) 03/05/78 1433
ADDRESS GIVEN BY

FELIX G. ROHATYN

ON

FEBRUARY 23, 1977

BEFORE

THE DEADLINE CLUB

and

THE NEW YORK ASSOCIATION OF FINANCIAL WRITERS
For three months we have now struggled to solve problems raised by the Moratorium Act being declared unconstitutional.

This has meant not only making plans to raise $1 billion in cash over a reasonable period of time but because of a profound difference in financing strategy between banks on the one hand and City and MAC on the other, has brought to the forefront, long before anticipated, the issue of the marketability of city paper. This is an issue that normally would have come to the forefront in the summer or fall of 1978, after the city's budget was put in place and as part of a program to determine market access needs of City at June 30, 1978 when current Federal Seasonal Loan Act expires. To have any kind of hope to have the Act extended, which I believe will be needed, City would obviously have to do whatever was needed to re-enter the market. This would undoubtedly include a longterm monitor with considerable powers over the budget. Whether the monitor is MAC, Son-of-MAC or YMCA, is irrelevant. The monitor will have to be there.

The following sequence of events would have been different and, in our view, more logical and orderly.

First, the financing of moratorium notes through MAC, stretch, Mitchel-Lama;

Second, State financing and City budget balance;

Third, City bond without crisis.

Unfortunately, this did not happen and we are now in the middle of a "lengthy crisis, with unions, banks and city taking positions which, of
necessity, have to be public. The danger of such a crisis remaining unresolved is, at worst, bankruptcy, but without a doubt will ultimately be costly to the City and State by making their respective financings costlier as a result of controversy and uncertainty. Neither City nor State can afford such cost. For instance, in December MAC was informed by its investment bankers it could raise $500,000,000 at 9%. Continued delay, market change, controversy no longer make this possible. This is most regrettable.

One of the issues I find so distressing is how quickly passions, which seemed at least subdued over the past two years, have now flared up again. The partnership which kept the City from bankruptcy included MAC, the banks, the unions and the State. The Federal Government capped this partnership with Seasonal Loan Act which, however, is nothing more than the Feds lending the City its own money six months ahead of time, fully secured and with $23,000,000 per year service charge. Everybody sacrificed*(examples)

Now the partnership is in disarray and the level of rhetoric is rising. Unions flail away at banks attempting to control City, the State and the EFCB. Bank spokesmen mutter darkly about the evils of MAC and the requirements of the marketplace "West of the Hudson". Editorials rail on all sides of the question, and the end is nowhere in sight.

Why does the City problem unleash such passions? What is there about this financial problem that sends everyone reaching for their ideological swords. As someone who is regularly and virulently condemned by the Village Voice as well as the Wall Street Journal and Barron's, it seemed to me that this was worth examining. It is all the more important since the passion and the ideology, the continued Crisis Management and the fever pitch that goes with it, have prevented a public debate over the issues that will determine the kind of future this City is to have, namely, its economic base and its social structure.
Everyone knows that New York's problems were partly of its own doing, partly the doing of others, partly just history changing. Blame for the past will be for a future historian, and there is more than enough to go around. It is probably poetic justice that many who share responsibility for the problem, City, State, unions and financial community and, finally, the Federal Government, will have to work out the longterm solution hopefully enlightened by the road traveled so far. This may, however, be wishful thinking.

New York City is more than just a municipality. To the rest of the country as well as to a large part of the world it is both a social and an economic symbol. To those millions and their descendants who came to this country through the cities' gateways, it is a symbol of freedom and opportunity and of caring for the individual. To many others West of the Hudson, South of the Mason-Dixon, it is a symbol of the ultimate bankruptcy of liberal thinking, brought to its outer limits, of the destruction of those values that made this country great, thrift, hard work, incentive to do it on your own, all caused by inept political leadership, the rapaciousness of labor leaders, the greed of the financial community, and the infinite capacity to try to get something for nothing by human nature left to its own devices. In this view New York is Sodom.

When large problems become social and philosophical symbols, it is impossible to keep a high level of emotion out of discussions relating to its solutions. Truth, as in Roshomon, is many faceted. New York and its problems, and New York and the solutions to its problems include everything that has been argued on every side of the case for the last two years. In charting a course of action, however, it is best to keep emotion out of the intellectual process and try to ascertain what is best
for New York in the context of what is best for the country. That includes social issues, economic issues, international issues and philosophical issues. Both from New York's point of view and from the national point of view it would appear to be in everyone's interest to find a solution with the least economic and social dislocation, both locally and nationally. This thesis has been at the heart of everything we have tried to do in the past two years. It is clear, in a democratic society, that major directional change by large social units cannot take place abruptly without the danger of massive unrest. New York City's budget is second in this country only to the Federal Government's, and is the size of many smaller countries throughout the world. Its present structure, financial and organizational, is the result not of six months or a year of excesses, but of ten to twenty years of pressures and counter-pressures. It cannot therefore, be cured in a short period of time, either financially or politically.

This lay at the heart of our absolute conviction that bankruptcy would be the death knell of the City. The conservative, as well as the liberal arguments for bankruptcy, with diametrically opposed logic, are both totally fallacious. They were both passionately made.

Today we hear with equal passion, words like "financial control over the City", "failure of political process", "home rule", etc. It is as if we were in the Summer of 1975 all over again. And yet, the fundamental question is being totally ignored, namely: "Where is this City going?" A solution to the Moratorium problem, important as it is, is not the real answer. Access to public markets, vital as it may be, is a means to an end but not the end itself. The end is the economic and social future of the City 10, 15, 20 years from now. This is what this is all about and it requires a strategy and a vision which the current crisis is distracting us from.
My involvement in City politics is and will continue to be threefold: I live here, I work here and I vote here. Period. That, however, entitles me at least to speak out and ask questions.

Statistics released Monday showed the City losing a further 117,000 jobs between June 1975 and November 1976. Mobil Oil announced its intention to move its headquarters because it was unable to attract young executives. This is the real crisis, not the Moratorium crisis. Any recovery of the City calls not only for the maintenance of its present business base but for the attraction of new businesses and taxpayers. How is this going to happen, where will they come from?

The City, in the last two years, has made important strides. The 3-year plan, which nobody believed could be accomplished, stands a good chance of being brought about, albeit requiring help through a stretchout of MAC. Considering inflation, costs, etc., this is a considerable achievement. Improvement in management, new people, new techniques, new attitudes have contributed. The idea that efficiency is the antithesis of social responsibility has been exposed for the total copout it is. City managers have accepted the validity of that thesis. Without bankruptcy, most of the City's short-term debt has been refinanced through MAC (average life 12 years, average interest rate 8%), major structural and fiscal change has been made and the deficit has been dramatically reduced.

What has not yet been achieved is a realistic approach to the City's long-range future and a clear acceptance and understanding of the notion that you cannot get something for nothing.

**EXAMPLE:** The City selling Mitchell-Lama mortgages for $356,000,000. The cost has been $1,150 billion. The City has lost $800,000,000 on this particular Rent Subsidy program, but no one questions whether it was worth it. It may be desirable but what is the cost? $100,000,000 for 8 years will pay for a lot of policemen, firemen, teachers, etc.
OR $50,000,000 in tax reductions

$50,000,000 in day care centers - training for hospital workers

might keep business here and provide services and human way of handling
major problems. It is too late to do anything about the loss - the money
is gone. At least there should be a drawn, a debate engaged.

ANOTHER EXAMPLE: The City now has a judgment against it for $1.0 billion.
The Transit System is operating at a large deficit and is in need of
additional revenue - capital spending. When a judge orders tolling for
the East River bridges to satisfy EPA, the reaction is that we are giving
away our birthright. Why is paying the East River toll more immoral than
the Triborough or the Tunnel. Shouldn't tolling bridges be looked upon
as possibly:

1) Source of financing to pay off the Moratorium.
2) Source of revenue to keep the fare at this level.
3) Source of financing for new investment.
4) A combination of above.

There is no suggestion of interrelation. Last week a woman teacher was
raped and sodomized on the subway while on the way to a church meeting.

Sooner or later the conclusion might be reached that the tolls might provide
more protection; not paying the tolls may not be a worthwhile saving.

A realistic approach has to be taken with respect to the overall economic
future of the City. Private jobs are the answer, but how? More services
as well as tax reduction - What mix? How do we get reduction in
unemployment and despair out of the ghetto if we don't have an educational
system that educates and if we don't have a job market that employs? How
do we get tax relief at the City and State levels to be competitive?
The City, by itself, cannot do it all. The City must have a view - economic and philosophical - of where it is and where it is going. Spending a lot of money to advertise what a great city it is is okay, but it is not enough.

Large scale manufacturing will probably not return for the foreseeable future because of too many regional competitive factors. In a major way, only those operations related to Regional Energy Development Corp. could be funneled to Northeastern cities, coupled with countercyclical tax credits.

Leisure, service, entertainment, communications, headquarters, light industry, are assets that could be built upon. A Convention Center by itself is not an answer; legalized casino gambling in selected areas, by itself, is not an answer; the 1984 Olympics by themselves (at low cost) are not an answer, but they all may be part of a strategy. It may be the wrong strategy, but it is worth talking about.

The State and Federal Government will obviously have to be part of the strategy. Tax reduction, new investment, service restoration can probably only happen as part of the Federal Welfare takeover, but the strategy must be ready, whatever it is. Rent Control Reform, Pension Reform, a regional transportation, may only come about as part of a continued Federal Loan program, or Federal guarantees, but the positions should be known.

In 1978, to the extent that reform at both the City and the State level has so far been incomplete we must expect the Federal Government to set conditions requiring more reform so as to make its loan more secure both then and in the future. This could include administrative and legislative actions that could affect the City's expenditures, as well as increase the
City's tax revenue base.

Only the Federal Government can adopt an explicitly structural approach which requires, or provides incentives for State, County and suburban governments to change their boundaries in order to enlarge, or in some other way change, the structural character of central cities, and thus their resource base... The Federal Government running a deficit of some 60 to 70 billion dollars cannot be looked upon as a source of enormous largess to New York or to any other city. However, continuation of loan or guaranteeing State Agency bonds of the MAC type is actually income producing with very limited risk and, ultimately, federalizing local share of welfare is a limited burden. Furthermore, should the marketplace require controls philosophically or politically impossible alternative Federal financing with direct Federal controls may have to be examined more closely.

Having a vision of the City is not necessarily romantic. There is nothing lyrical about poverty and nothing esthetic about unemployment. But unemployment and poverty have to be met with a strategy local and national to provide a competitive environment, services and private jobs. Bankruptcy is not the answer; a new city bond is not the answer; a new MAC is not the answer. And there has to be an answer.

New York is a glittering jewel of culture, finance, trade and industry. It is a symbol to the rest of the world that opportunity still has meaning. It is also poverty and illiteracy, hopelessness and drugs, lives aborted after birth by coming into an environment devoid of hope for social or economic improvement.
For the foreseeable future, Western democracies will have to do with less as a result of energy costs, social needs, decreased productivity, etc. It will require imagination, leadership, & dedication. Less, in our world, is not necessarily good. Less of the same is terrible.

How we can maintain the best and resolve the worst, with help from the State, Region and Federal Government, is the real crisis facing this City. 1977 will, in many ways, be an important year for the City. Those of us who live and work here will watch and listen and vote.
Mr. Chairman, Members of the Committee:

Governor Carey has asked me to comment on the plans for dealing with the recent Court of Appeals decision which declared unconstitutional the three-year moratorium on the last City notes still held by the public.

These notes represent an accumulation of City deficits and capital expenditures which ought to be amortized over a number of years through the issuance of medium-term debt. This refinancing could have been accomplished—and the noteholders paid—under the legislation this Committee developed last year. However, the legislation sponsored by the Administration made no provision for these notes. We were forced to attempt to postpone payment of the notes until the City had accomplished its three-year program of austerity and reform and might use its own credit to effect the refinancing. The only thing we were able to offer the noteholders was to exchange their notes for M.A.C. bonds which quite correctly reflected the reality of the economic situation.

In a sense, our approach to the Court's decision illustrates how much austerity and reform have been accomplished. A few months ago there was serious discussion of stretching out the three-year plan and extending the moratorium as well. Now, the City seems to have serious plans for meeting its three year deadline for a balanced budget, and we have a proposal, which, if agreed to, can provide payment of the notes well before the moratorium was set to expire.

This change in outlook results not from the discovery of some hidden resources in the City but from the very changes in financial management and policy which were initiated a year and a half ago.
Our plan to deal with the moratorium decision still recognizes that these notes ought to be amortized over a reasonable period of time. While the City can generate some cash from internal sources, the majority of the funds will have to come from the voluntary rearrangement of certain existing debt and from the proceeds of new borrowing.

The principal elements of the proposal developed by M.A.C. and the City are the following:

- A voluntary restructuring of $1.8 billion of M.A.C. ten-year debt held by certain New York City institutions—mainly banks and pension funds—which could make available $206 million for noteholders in the current fiscal year, if stretched to fifteen-year maturities.

- A sale of M.A.C. securities to certain institutions, such as State and City pension funds, commercial banks and savings banks. Such a sale, of between $250 and $300 million, could employ short-term M.A.C. securities related to savings over the next few years from the restructuring I just mentioned. These securities might be convertible into longer term City bonds, if the City continues to balance its budget and meet other financial conditions.

- A public sale of M.A.C. securities, also of between $250 and $300 million. The recent successful sale of M.A.C. bonds convinces me that, if the rest of the plan can be put together, the strong current bond market would accept this new offering at a reasonable rate of interest. The current favorable market climate may obviously, no longer prevail if our negotiations are too protracted.
Perhaps $250 million in cash generated by the City, using the previously planned refinancing of Mitchell-Lama mortgages on middle-income housing.

We estimate that these elements of our proposal could be committed and accomplished on a schedule that would produce $206 million by February 1, approximately half of the total by June 30, and the balance by next November 19, one year from the Court's decision. However, none of the parties whose agreement is required to implement this plan has given us an agreement. In particular, the plaintiff's attorney has told us he will accept our schedule of payments but not our condition that we obtain the consent of the banks, pension funds and others. He has asked the Court to enter an order fixing an absolute schedule of payment, and we have thirty days either to obtain the commitment of the various parties or to seek some other form of order.

In attempting to convince the parties to participate in the solution we propose, we believe the impact of the financing on the City's future budgets and property tax rates will have a persuasive effect. Because existing City and M.A.C. debt are of relatively short maturity, the new debt may be so structured that it is likely to have little or no budgetary impact and can be serviced with little or no change in the property tax rate. These results appear to hold true even after assuming some future borrowing to carry out a City capital program.
Address Given By

FELIX G. ROHATYN

before

UNIVERSITY OF HARTFORD TAX INSTITUTE

November 12, 1976
I am honored to be the guest speaker at this luncheon for the University of Hartford Tax Institute. I come before you to speak about the essential changes that have come out of the last year and a half of gloom and crisis in New York City, and also to explore the many tasks still ahead if we are to stop the spiraling fiscal and social decay, not just in New York but in all of our older cities. I am a financial surgeon, not an urban expert. If I am expert in anything it is in financial structures. I try to put the pieces back together without leaving too many scars and without spilling too much blood. I have however, made the classic mistake that any professional can make, whether lawyer, surgeon, engineer, etc. I have become emotionally involved with my patient; my patient is the City of New York. I am therefore here to tell you what I found when we first became involved with the City and the judgements that we've made as we went along. I must speak to you from the perspective of New York since that is my sole experience. You must take into account that my judgements may be flawed by a level of emotional involvement that could be unsound.

I like large cities. I was raised in Vienna, Paris and New York. I subscribe to Eric Hoffer's statement that "Not a single human achievement was conceived or realized in the bracing atmosphere of steppes, forests or mountaintops. Everything was conceived and realized in the crowded stinking little cities of Jerusalem, Athens, Florence, Shakespeare's London, Rembrandt's Amsterdam."
In May of 1975 Governor Carey asked me and three other private citizens to study the financial structure of New York City and to recommend to him, specifically, the answer to two questions:

1) Whether bankruptcy was an acceptable alternative and,

2) If the answer was negative, to recommend a course of action to avoid the bankruptcy and refinance the city.

At that time my knowledge of the City was strictly limited to what I read in the New York Times. I had never met a Mayor, or a Controller or a Governor. In fact, I believe that I had never met a state or city official. My state of municipal virginity was total. That state has since changed dramatically.

The cry for bankruptcy was originally argued by the conservative end of the political spectrum as the only way to break pension agreements that were burdening the city. The same argument was later made by the Liberals as a way to wipe out the debt and restore debt service monies to public services. Both arguments are fallacious. There is no need to break the unions and there is no way to wipe out the debt. The inter-relationship of the State and the City is such that to talk about the survival of the former and the bankruptcy of the latter is sheer fantasy. From a national point of view, the fact that the City, the State and its agencies account for over $30 billion of securities, which in turn represents about 20% of the capital of the entire U.S. banking system, I believe speaks for itself. Bankruptcy will not wipe out the unions, will not wipe out
the debt; it will only wipe out the City. Having made the determination, we recommended the creation of the Municipal Assistance Corporation as a vehicle to refinance the City. Its financial condition at that time showed a total amount of $6 billion of short term debt coming due within 12 months, with no market. It showed a requirement for an additional $2 billion to finance both its current deficit and a modest capital construction program. It showed the State of New York in very precarious financial condition, obviously not able to shoulder significant further city involvement. It showed a federal government willing to run the most appalling risks, both to the social life of the City and the economy of the country, in the name of a most dubious theology.

We were faced with a City budget deficit of uncertain dimension but falling somewhere in the range of $1.2 to $1.5 billion annually, and a lack of those accounting systems required to determine that deficit with certainty and to permit city managers to run their operations with success. Our action was twofold: taking steps to stop the financial hemorrhage to which the City was prey and financing the City as best we could. Drastic actions were undertaken, all of them painful, some of them counter-productive if continued for too long. These included:

1) $500 million in additional taxes.

2) A drastic wage policy including both a wage freeze as well as a policy of cost-of-living adjustments paid solely out of measured productivity improvements.

3) A brutal reduction in the labor force, 53,000 people being taken off the payrolls in the last 18 months, out of a total of approximately 290,000, or almost 20%.
4) A moratorium on City short term notes, which still covers approximately a billion dollars of those notes.

5) The State despite its shaky condition, lending $750 million to the City through the Municipal Assistance Corporation and creating the Emergency Financial Control Board to control the fiscal life of the City.

6) Tuition at City University for the first time in 120 years.

7) The State increasing its share of the funding of City University.

8) A transit fare increase of almost 30%.

9) The management of the City beefed up with the appointment of a new First Deputy Mayor, a Deputy Mayor for finance, a budget director, a head of social services, and an economic development director, the latter four from the private sector.

A three-year plan was embarked upon which has now run about half its course. These actions permitted us to raise a total of $9 billion financing, which included $2.3 billion of seasonal loans from the Federal Government, $3.7 billion of commitments from the union pension systems, and $1.8 billion from the local Clearing House Banks.

As a result of these measures the financial position of both the City and the State have improved. The State, which last year at this time was
totally out of the financial markets, was able to complete $4 billion of financing last spring and refinance to the extent of $2.5 billion all the State construction agencies. A month ago, the State Housing Finance Agency, which had been out of the markets for a year sold $150 million of bonds publicly. More significantly, last week MAC entered the public markets for the first time in over a year with a stunningly successful sale of a quarter of a billion dollars worth of MAC bonds to the general public. This financing permitted the repayment to the State of the $750 million dollars advanced to the City in its time of need. The prices of MAC bonds in the marketplace have steadily improved, although in my judgement still in no way reflecting the true credit values of MAC. The Federal Loan Program, which was put into place a year ago, is continuing into this fiscal year and is on track.

These events, together with continued City retrenchment and reduction in its massive deficit are in my judgement significantly and, possibly dramatic change. It is worth speculating on what might have occurred had no action been taken a year and a half ago and financing been continued as before. It has been estimated that, at the rate the City was operating the deficit would currently be between two to two and a half billion dollars. To reduce that theoretical but nonetheless inevitable deficit to the current level of some $700 million in a year and a half, in a climate of economic recession in the City, taking into account the continued level of inflation, starkly outlines the dimension of retrenchment; indeed, there was a significant amount of fat, but, at the same time, we are biting very, very deep.
Where does that leave us today? The city's failures were of two kinds. The mismanagement of programs and the mismanagement of finance. The city's management of those agencies directly under the Mayor's control namely Fire, Police, Sanitation and Welfare has seen significant improvement, although alot can still be done. New appointments, new data available to the City management, a new attitude with respect to management have all contributed to this improvement. In that connection, the idea that efficiency is the antithesis of humanism has now been exposed for the total cop-out that it is. When there is no money for the luxury of feather-bedding, of amateurism and of political cronyism then efficiency is the only weapon available to produce the savings required to permit the maintenance of vital services. The City managers have accepted the validity of that thesis. There are areas that are not under the direct control of the Mayor, our so-called covered agencies, the Health and Hospitals Corporation, the Board of Education, the Transit Authority, where serious improvement still has to be made. The control of those agencies may require legislative change in Albany. Whatever is necessary will be obtained. One of the things I learned recently is that the genius of Alfred P. Sloan when he built the General Motors Corp. was to build a system whereby large units could be run by people who are not geniuses, because the controls and systems to run those units are in place. A city is totally the opposite. It is the ultimate non-system. It requires genius to manage in any way, shape or form And it is run by people who are usually rather at the other end of the intellectual spectrum.
In the fiscal and financial areas, significant progress has been made. The debt and the deficit structure of the City were a result both of its own fiscal and financial mismanagement and of an astounding willingness on the part of the financial community to provide excessive and unsound financing. We have, through M.A.C., stretched out the City's short term debt significantly. Our deficit has been reduced and accounting systems are being put in place. A significant change in labor relations has taken place with the labor leadership cooperating in a program of massive personnel reductions, wage freeze and productivity improvements, coupled with major investment in M.A.C. paper by their pension systems. A beginning of pension reform has taken place in the Legislature in Albany.

These are the actions that were taken to stop the hemorrhage. The surgery was drastic and is continuing, but unless therapy is brought to bear soon, we might have a brilliantly successful operation and a dead patient. The steps that have been taken are those required to stabilize the situation. They won't turn our economy around, and they won't turn the economy of the State around. We have proven in New York City, without the shadow of a doubt, that Keynesian economics work. In a recessionary environment we have increased taxes and cut employment and practiced the most brutal kind of deflation. We have thereby institutionalized recession in our local economy. Our actions were inevitable due to the requirements of a balanced budget and to the State's financial fragility,
as well as constitutional limitations with respect to credit. We had the choice of doing this or going bankrupt. Faced with the same alternatives, I would do it all over again. We were not given a choice by a Federal Government willing to sit by and watch us go over the brink.

Where do we go from here? We have seen, in New York, in the decade of 1960 to '70 a fifty percent reduction in manufacturing employment, mostly offset by service jobs and municipal employment. This downward trend in private employment is still continuing, but is now reinforced by a parallel trend in municipal employment. During the same period, median family income in real terms, when tax increases and inflation are factored in, showed a net decrease in real terms. Per capita expenditures which were 5% below the national average five years ago, are now 20% below the national average. The number of families below poverty level increased by 8% over the last five years while the national average declined by 2%. We have in the State of New York the highest percentage of citizens over 65 years of age of any state in the country. These trends seem to indicate that we are going to a demographic mix that is reminiscent of Georgia and Arkansas of 40 years ago. The younger, wealth-creating tax payers are migrating out leaving us with a higher and higher percentage of the poor and the aged, requiring higher and higher levels of service support.

The State of New York during that period participated fully in the approval of burdensome pension agreements, as well as setting a miserable example with the reckless use of moral obligation bonds. In addition, the State did not participate adequately in the funding
of the City University system and did not pay its fair share of the Court and Correction system. At the same time the Federal Government, pursuing a deliberate policy of Southern and Western development as well as a policy of suburban vs. urban development watched our wealth being drained away and sat by while national poverty moved from the South to our urban areas and saddled our local communities with a disproportionate share of the burden.

To recover, we have to have long term policies at the level of the City, the State, the Region and the Federal Government. The City of New York is no longer a viable economic unit. It was never an appropriate instrument for income redistribution. The retention and the creation of private jobs has to be the primary goal of a development policy by the City and the State. General and selective tax relief to keep those businesses that are here and hopefully to attract new ones is necessary. We must take advantage of the incomparable assets of the City, of its culture, of the arts, of the talent of its people to make it a many-faceted mecca for the rest of the country as well as to attract the tens of thousand of Europeans who view with alarm the leftward drift of their respective governments. This time around New York should look to Europe and say "Give me your rich."

It is impossible to speak of economic development without touching on the issue of the quality of life in the City of New York. To keep those businesses we have and to attract new ones requires a conviction on the part of people moving to the City that public education in New York indeed provides education. At this point this is not a perception shared by everybody. Development will have to include a housing policy which faces up to the issue of rent control and provides
decent housing for those who cannot afford it, but requires payment from those who can. A consistent labor policy which equates benefits gained with measured determinable productivity requires not only labor co-operation but a level of management sophistication to which the City must dedicate itself. Innovation in approach, ideas such as turning the Sanitation Department into a private company owned by the union and cleaning the City under contract, should be studied. We must build on the co-operative spirit with which the Unions, M.A.C. and the financial community worked last Fall and recognize that without a commitment from the unions of $3.7 billion bankruptcy would have been unavoidable.

The region around us, the suburbs to which our taxpayers fled must be made to recognize that they have to pay a fairer share of the City costs. Only cities such as Houston, which have been able to recapture their fleeing taxpayers, have been able to keep their finances together. Regional transportation taxes and other similar burden sharing have to be enacted. No one should be permitted to forget the inadequacy of our tax borders. The fact that Connecticut is raiding our corporate headquarters and New Jersey is stealing our brokerage houses should not obscure the reality that sooner or later we will all sink or swim together. A look at the last decade of statistics for Pittsburgh or Philadelphia, for Newark or for Hartford, for New York or for Boston indicates that although New York may be a caricature of what has been happening, nonetheless the same forces will inevitably catch up with these other cities. Only the Federal Government can adopt an explicitly structural approach which requires or provides incentives for State, County and
suburban governments to change their boundaries in order to enlarge, or in some other way change, the structural character central cities, and thus their resource base.

The legislation governing both M.A.C. and the Federal Loan Program requires the City to be in balance at the end of fiscal 1978. This will require additional cutbacks over and above those already in place of approximately $500 million for the next fiscal year. Whether this can be done, considering the current continued lag in the city's economy, without at the same time tearing the city apart, is open to question. Reduction in services as a result of layoffs and attrition will soon reach a critical level. Additional layoffs, beyond those in the fiscal plan, are becoming counter-productive by creating additional unemployment costs and a drag on the economy. What New York desperately needs is not a mechanism to carry its deficit beyond June of 1978. What is needed is a mechanism to restructure the debt in order to lengthen its maturities and lower its interest rate. A federal guarantee of M.A.C. bonds, or a long term loan to M.A.C., would result in a saving of as much as $200 million per annum in the next years of the financial plan. M.A.C. bonds are amply secured by sales and stock transfer taxes, and the Federal Government would be performing a perfectly rational banking transaction. In addition, by making federally guaranteed bonds taxable, the government would, over the life of the bonds, generate considerable Treasury revenues that are presently not collected. At the same time, with a balanced budget and a federally guaranteed M.A.C., outstanding City bonds, which are also of short maturities, could be refinanced in the open market, further reducing
debt service as well as level of taxation. This would be of enormous stimulus to our economy. Ultimately, but obviously not tomorrow, assumption by the Federal Government of the local share of welfare, which is a sine qua non to our survival, should provide the City with significant funds to restore vitally needed services as well as to embark on a significant program of economic development. This program both at the City and the State level has to include broad tax reduction to make us more competitive with neighboring states and regions.

In addition to these efforts we will continue the regional initiative started last May by Governors Carey and Byrne which resulted in the Co-alition of North East Governors. This group of seven states is now working on a three-part program for our region consisting of:

1) A program of increased Federal counter-cyclical revenue sharing funds as well as changes in Federal formulas.

2) A program of counter-cyclical investment tax credits of accelerated depreciation rates related to impacted areas.

3) A Regional Energy Development Corporation, with federally guaranteed bonds, to undertake large scale regional projects aimed at producing jobs and reducing energy costs and use throughout the region.

Furthermore, the Co-alition will undertake joint political action to redress a situation which saw the North Central and Northeastern States pay to Washington $43.7 billion more in taxes than they received
back, while the Sun Belt was getting $31.5 billion more than it paid. Such a program will obviously require Federal involvement and Congressional approval.

Any number of studies by prestigious, intelligent, foresighted groups have made studies with respect to urban problems. Any number of policies and solutions have been advanced, all of which have something to be said for them. What the New York crisis can do, is to provide a focus to frame a national attitude which is now as important as specific policies. The United States has historically been the most generous country in the world with respect to any problems outside of its own shores. After W.W. II the U.S. brought Europe back to life with a massive economic aid program entitled the Marshall Plan. Aid to underdeveloped countries started in the fifties, then took on massive importance. Both financial assistance, grants and long-term loans as well as management assistance through initiatives like the Peace Corps, went forth to Africa, to Asia, to the third world with mixed results but always with good intentions. Let us do the same thing within our borders. Our older cities are like the devastated cities of Europe after W.W. II as well as the underdeveloped countries of the Third World, and our approach to their problems should be guided by the same principles. A complicated problem can only be tackled with someone clearly in charge; a cabinet level Department of Urban Affairs, whose sole function will be to administer a Marshall Plan to bring the cities of this country back to life, is an absolute necessity. This Marshall Plan will not mean simply throwing money at cities but it will be a national symbol of dedication to urban civilization. This should include the involvement both of the private
and the public sector. In the public sector massive physical re-construction of blighted city areas ia an immediate priority.

In the private sector, tax incentives that will make it economical and attractive for business to locate itself in urban areas, either through direct subsidies or through indirect support, such as the use of large scale industrial parks, would be another formula. Construction is one of the most economically stimulative activities that this country can embark on. A massive physical urban reconstruction program would be socially desirable as well as economically stimulative. It would also permit the utilization of a large, presently unemployed labor force in the cities with a reduction of the current risk of social unrest and despair. Again on the model of what we have done abroad in underdeveloped areas, an Urban Peace Corps should be formed. Corporations operating in urban areas would make available young executives for service in city administration for a year or two. These young executives should be used to seed city agencies and departments and to provide rational and innovative management techniques.

The days of capital surplus are over, and until a significant reversal of the present economic realities in cities is brought about, efficiency is going to be at a premium. Corporations, large and small, should conclude that experience in local government and the management of municipal insitututions will be a plus to their young executive.

Finally, an Urban Development Bank should be created to help finance such a Marshall Plan either through direct loans or through a subsidiary which could guarantee appropriate municipal securities such as M.A.C.
I will not burden you with a litany of dreary statistics on the urban crisis, with which you are all too familiar. Our older cities have experienced massive and crippling disinvestment, with a resulting social and economic apartheid and enormous waste of physical and human resources. The disease is now spreading to entire regions. Recent surges in the cost of energy and food to those regions have increased the cost to residents and business, and further depressed economic activity and investments in these areas.

A Conference of Mayors has just finished meeting in Chicago with a variety of recommendations for Federal action. Many of these are included in the programs that we have started and supported, both in our efforts with respect to New York City and State, as well as our recent effort with respect to the Co-alition of Northeast Governors. Federalization of the local share of welfare, greater use of counter-cyclical funds, counter-cyclical tax credits, regionalizing tax borders, regional development corporations and Federal Loan programs are all part of such an effort.

Basically, only Federal stimulus will ultimately reverse the downward trend of the economies of our older cities. Major efforts are needed to break out of the vicious downward cycle of cutbacks followed by economic erosion followed by more cutbacks. Only massive shifts from welfare to employment can break the cycle of poverty and hopelessness in the ghetto. The truly important abortion issue in this country concerns those lives that are aborted after birth, by coming into an environment that offers no hope for social or economic improvement. Life in the ghetto can be abortive after birth. In a world where
ideas have more power than hardware, our defense budget, no matter what its size, will not keep Italy from going Communist. Translating words into deeds will make the difference, showing whether we can provide opportunity for the poor, the Black, the unemployed and uneducated in this country; whether we can provide private jobs in an economy based on functioning free enterprise. Over the next decade this question will be answered in the slums of Cleveland and in the ghettos of Harlem, which is where both our foreign and domestic policies should begin. Our older cities are suffering from the cancer called poverty, unemployment, lack of education and racial prejudice. Dylan Thomas wrote a poem to his dying father saying, "Do not go gentle into that good night. Old age should burn and rave at close of day. Rage, rage against the dying of the light." The older cities will not "go gentle into that good night." Unless their cancer is contained and cured their rage will explode and will be felt not only in this country but all over the world. If that were to happen, our Bi-Centennial, instead of being a joyous anniversary, will have turned out to be the beginning of the end.
Keynote Address Given By

FELIX G. ROHATYN

Before

NATIONAL COUNCIL FOR URBAN ECONOMIC DEVELOPMENT

November 11, 1976
I am both flattered and somewhat depressed to have been asked to be the keynote speaker for the National Council for Urban Economic Development. Flattered for quite obvious reasons; depressed because it is obvious both to you and to me that I am not an urban expert. Keynote speakers to urban development conferences should be urban experts. I think it's probably symptomatic of the times that you picked someone of my discipline to speak here. I am a financial surgeon and not an urban expert. If I am expert in anything, it is in financial structures. I try to put the pieces back together without leaving too many scars and without spilling too much blood. I have, however, made the classic mistake that any professional can make, whether lawyer, surgeon, engineer, etc. I have become emotionally involved with my patient; my patient is the City of New York. I am therefore here to tell you what I found when we first became involved with the City and the judgments that we've made as we went along. I must speak to you from the perspective of New York since that is my sole experience. You must take into account that my judgments may be flawed by a level of emotional involvement that could be unsound.

I like large cities. I was raised in Vienna, Paris and New York. I subscribe to Eric Hoffer's statement that "Not a single human achievement was conceived or realized in the bracing atmosphere of steppes, forests or mountaintops. Everything was conceived and realized in the crowded stinking little cities of Jerusalem, Athens, Florence, Shakespeare's London, Rembrandt's Amsterdam."
In May of 1975 Governor Carey asked me and three other private citizens to study the financial structure of New York City and to recommend to him, specifically, the answer to two questions:

1) Whether bankruptcy was an acceptable alternative
   and,

2) If the answer was negative, to recommend a course
   of action to avoid the bankruptcy and refinance the
   city.

At that time my knowledge of the City was strictly limited to what I read in the New York Times. I had never met a Mayor, or a Controller or a Governor. In fact, I believe that I had never met a state or city official. My state of municipal virginity was total. That state has since changed dramatically.

The cry for bankruptcy was originally argued by the conservative end of the political spectrum as the only way to break pension agreements that were burdening the city. The same argument was later made by the Liberals as a way to wipe out the debt and restore debt service monies to public services. Both arguments are fallacious. There is no need to break the unions and there is no way to wipe out the debt. The inter-relationship of the State and the City is such that to talk about the survival of the former and the bankruptcy of the latter is sheer fantasy. From a national point of view, the fact that the City, the State and its agencies account for over $30 billion of securities, which in turn represents about 20% of the capital of the entire U.S. banking system, I believe speaks for itself. Bankruptcy will not wipe out the unions, will not wipe out
the debt; it will only wipe out the City. Having made the determination, we recommended the creation of the Municipal Assistance Corporation as a vehicle to refinance the City. Its financial condition at that time showed a total amount of $6 billion of short term debt coming due within 12 months, with no market. It showed a requirement for an additional $2 billion to finance both its current deficit and a modest capital construction program. It showed the State of New York in very precarious financial condition, obviously not able to shoulder significant further city involvement. It showed a federal government willing to run the most appalling risks, both to the social life of the City and the economy of the country, in the name of a most dubious theology.

We were faced with a City budget deficit of uncertain dimension but falling somewhere in the range of $1.2 to $1.5 billion annually, and a lack of those accounting systems required to determine that deficit with certainty and to permit city managers to run their operations with success. Our action was twofold: taking steps to stop the financial hemorrhage to which the City was prey and financing the City as best we could. Drastic actions were undertaken, all of them painful, some of them counter-productive if continued for too long. These included:

1) $500 million in additional taxes.

2) A drastic wage policy including both a wage freeze as well as a policy of cost-of-living adjustments paid solely out of measured productivity improvements.

3) A brutal reduction in the labor force, 53,000 people being taken off the payrolls in the last 18 months, out of a total of approximately 290,000, or almost 20%.
4) A moratorium on City short term notes, which still covers approximately a billion dollars of those notes.

5) The State despite its shaky condition, lending $750 million to the City through the Municipal Assistance Corporation and creating the Emergency Financial Control Board to control the fiscal life of the City.

6) Tuition at City University for the first time in 120 years.

7) The State increasing its share of the funding of City University.

8) A transit fare increase of almost 30%.

9) The management of the City beefed up with the appointment of a new First Deputy Mayor, a Deputy Mayor for finance, a budget director, a head of social services, and an economic development director, the latter four from the private sector.

A three-year plan was embarked upon which has now run about half its course. These actions permitted us to raise a total of $9 billion financing, which included $2.3 billion of seasonal loans from the Federal Government, $3.7 billion of commitments from the union pension systems, and $1.8 billion from the Local Clearing House Banks.

As a result of these measures the financial position of both the City and the State have improved. The State, which last year at this time was
totally out of the financial markets, was able to complete $4 billion of financing last Spring and refinance to the extent of $2.5 billion all the State construction agencies. A month ago, the State Housing Finance Agency which had been out of the markets for a year sold $150 million of bonds publicly. More significantly, last week MAC entered the public markets for the first time in over a year with a stunningly successful sale of a quarter of a billion dollars worth of MAC bonds to the general public. This financing permitted the repayment to the State of the $750 million dollars advanced to the City in its time of need. The prices of MAC bonds in the marketplace have steadily improved, although in my judgement still in no way reflecting the true credit values of MAC. The Federal Loan Program, which was put into place a year ago, is continuing into this fiscal year and is on track.

These events, together with continued City retrenchment and reduction in its massive deficit are in my judgement significantly and, possibly dramatic change. It is worth speculating on what might have occurred had no action been taken a year and a half ago and financing been continued as before. It has been estimated that, at the rate the City was operating the deficit would currently be between two to two and a half billion dollars. To reduce that theoretical but nonetheless inevitable deficit to the current level of some $700 million in a year and a half, in a climate of economic recession in the City, taking into account the continued level of inflation, starkly outlines the dimension of retrenchment; indeed, there was a significant amount of fat, but, at the same time, we are biting very, very deep.
Where does that leave us today? The city's failures were of two kinds. The mismanagement of programs and the mismanagement of finance. The city's management of those agencies directly under the Mayor's control namely Fire, Police, Sanitation and Welfare has seen significant improvement, although a lot can still be done. New appointments, new data available to the City management, a new attitude with respect to management have all contributed to this improvement. In that connection, the idea that efficiency is the antithesis of humanism has now been exposed for the total cop-out that it is. When there is no money for the luxury of feather-bedding, of amateurism and of political cronyism then efficiency is the only weapon available to produce the savings required to permit the maintenance of vital services. The City managers have accepted the validity of that thesis. There are areas that are not under the direct control of the Mayor, our so-called covered agencies, the Health and Hospitals Corporation, the Board of Education, the Transit Authority, where serious improvement still has to be made. The control of those agencies may require legislative change in Albany. Whatever is necessary will be obtained. One of the things I learned recently is that the genius of Alfred P. Sloan when he built the General Motors Corp. was to build a system whereby large units could be run by people who are not geniuses, because the controls and systems to run those units are in place. A city is totally the opposite. It is the ultimate non-system. It requires genius to manage in any way, shape or form. And it is run by people who are usually rather at the other end of the intellectual spectrum.
In the fiscal and financial areas, significant progress has been made. The debt and the deficit structure of the City were a result both of its own fiscal and financial mismanagement and of an astounding willingness on the part of the financial community to provide excessive and unsound financing. We have, through M.A.C., stretched out the City's short term debt significantly. Our deficit has been reduced and accounting systems are being put in place. A significant change in labor relations has taken place with the labor leadership cooperating in a program of massive personnel reductions, wage freeze and productivity improvements, coupled with major investment in M.A.C. paper by their pension systems. A beginning of pension reform has taken place in the Legislature in Albany.

These are the actions that were taken to stop the hemorrhage. The surgery was drastic and is continuing, but unless therapy is brought to bear soon, we might have a brilliantly successful operation and a dead patient. The steps that have been taken are those required to stabilize the situation. They won't turn our economy around, and they won't turn the economy of the State around. We have proven in New York City, without the shadow of a doubt, that Keynesian economics work. In a recessionary environment we have increased taxes and cut employment and practiced the most brutal kind of deflation. We have thereby institutionalized recession in our local economy. Our actions were inevitable due to the requirements of a balanced budget and to the State's financial fragility,
as well as constitutional limitations with respect to credit. We had the choice of doing this or going bankrupt. Faced with the same alternatives, I would do it all over again. We were not given a choice by a Federal Government willing to sit by and watch us go over the brink.

Where do we go from here? We have seen, in New York, in the decade of 1960 to '70 a fifty percent reduction in manufacturing employment, mostly offset by service jobs and municipal employment. This downward trend in private employment is still continuing, but is now reinforced by a parallel trend in municipal employment. During the same period, median family income in real terms, when tax increases and inflation are factored in, showed a net decrease in real terms. Per capita expenditures which were 5% below the national average five years ago, are now 20% below the national average. The number of families below poverty level increased by 8% over the last five years while the national average declined by 2%. We have in the State of New York the highest percentage of citizens over 65 years of age of any state in the country. These trends seem to indicate that we are going to a demographic mix that is reminiscent of Georgia and Arkansas of 40 years ago. The younger, wealth-creating tax payers are migrating out leaving us with a higher and higher percentage of the poor and the aged, requiring higher and higher levels of service support.

The State of New York during that period participated fully in the approval of burdensome pension agreements, as well as setting a miserable example with the reckless use of moral obligation bonds. In addition, the State did not participate adequately in the funding
of the City University system and did not pay its fair share of the Court and Correction system. At the same time the Federal Government, pursuing a deliberate policy of Southern and Western development as well as a policy of suburban vs. urban development watched our wealth being drained away and sat by while national poverty moved from the South to our urban areas and saddled our local communities with a disproportionate share of the burden.

To recover, we have to have long term policies at the level of the City, the State, the Region and the Federal Government. The City of New York is no longer a viable economic unit. It was never an appropriate instrument for income redistribution. The retention and the creation of private jobs has to be the primary goal of a development policy by the City and the State. General and selective tax relief to keep those businesses that are here and hopefully to attract new ones is necessary. We must take advantage of the incomparable assets of the City, of its culture, of the arts, of the talent of its people to make it a many-faceted mecca for the rest of the country as well as to attract the tens of thousand of Europeans who view with alarm the leftward drift of their respective governments. This time around New York should look to Europe and say "Give me your rich."

It is impossible to speak of economic development without touching on the issue of the quality of life in the City of New York. To keep those businesses we have and to attract new ones requires a conviction on the part of people moving to the City that public education in New York indeed provides education. At this point this is not a perception shared by everybody. Development will have to include a housing policy which faces up to the issue of rent control and provides
decent housing for those who cannot afford it, but requires payment from those who can. A consistent labor policy which equates benefits gained with measured determinable productivity requires not only labor co-operation but a level of management sophistication to which the City must dedicate itself. Innovation in approach, ideas such as turning the Sanitation Department into a private company owned by the union and cleaning the City under contract, should be studied. We must build on the co-operative spirit with which the Unions, M.A.C. and the financial community worked last Fall and recognize that without a commitment from the unions of $3.7 billion bankruptcy would have been unavoidable.

The region around us, the suburbs to which our taxpayers fled must be made to recognize that they have to pay a fairer share of the City costs. Only cities such as Houston, which have been able to recapture their fleeing taxpayers, have been able to keep their finances together. Regional transportation taxes and other similar burden sharing have to be enacted. No one should be permitted to forget the inadequacy of our tax borders. The fact that Connecticut is raiding our corporate headquarters and New Jersey is stealing our brokerage houses should not obscure the reality that sooner or later we will all sink or swim together. A look at the last decade of statistics for Pittsburgh or Philadelphia, for Newark or for Hartford, for New York or for Boston indicates that although New York may be a caricature of what has been happening, nonetheless the same forces will inevitably catch up with these other cities. Only the Federal Government can adopt an explicitly structural approach which requires or provides incentives for State, County and
suburban governments to change their boundaries in order to enlarge, or in some other way change, the structural character central cities, and thus their resource base.

The legislation governing both M.A.C. and the Federal Loan Program requires the City to be in balance at the end of fiscal 1978. This will require additional cutbacks over and above those already in place of approximately $500 million for the next fiscal year. Whether this can be done, considering the current continued lag in the city's economy, without at the same time tearing the city apart, is open to question. Reduction in services as a result of layoffs and attrition will soon reach a critical level. Additional layoffs, beyond those in the fiscal plan, are becoming counter-productive by creating additional unemployment costs and a drag on the economy. What New York desperately needs is not a mechanism to carry its deficit beyond June of 1978. What is needed is a mechanism to restructure the debt in order to lengthen its maturities and lower its interest rate. A federal guarantee of M.A.C. bonds, or a long term loan to M.A.C., would result in a saving of as much as $200 million per annum in the next years of the financial plan. M.A.C. bonds are amply secured by sales and stock transfer taxes, and the Federal Government would be performing a perfectly rational banking transaction. In addition, by making federally guaranteed bonds taxable, the government would, over the life of the bonds, generate considerable Treasury revenues that are presently not collected. At the same time, with a balanced budget and a federally guaranteed M.A.C., outstanding City bonds, which are also of short maturities, could be refinanced in the open market, further reducing
debt service as well as level of taxation. This would be of enormous stimulus to our economy. Ultimately, but obviously not tomorrow, assumption by the Federal Government of the local share of welfare, which is a sine quo non to our survival, should provide the City with significant funds to restore vitally needed services as well as to embark on a significant program of economic development. This program both at the City and the State level has to include broad tax reduction to make us more competitive with neighboring states and regions.

In addition to these efforts we will continue the regional initiative started last May by Governors Carey and Byrne which resulted in the Co-alition of North East Governors. This group of seven states is now working on a three-part program for our region consisting of:

1) A program of increased Federal counter-cyclical revenue sharing funds as well as changes in Federal formulas.

2) A program of counter-cyclical investment tax credits of accelerated depreciation rates related to impacted areas.

3) A Regional Energy Development Corporation, with federally guaranteed bonds, to undertake large scale regional projects aimed at producing jobs and reducing energy costs and use throughout the region.

Furthermore, the Co-alition will undertake joint political action to redress a situation which saw the North Central and Northeastern States pay to Washington $43.7 billion more in taxes than they received
back, while the Sun Belt was getting $31.5 billion more than it paid. Such a program will obviously require Federal involvement and Congressional approval.

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A Conference of Mayors has just finished meeting in Chicago with a variety of recommendations for Federal action. Many of these are included in the programs that we have started and supported, both in our efforts with respect to New York City and State, as well as our recent effort with respect to the Coalition of Northeast Governors. Federalization of the local share of welfare, greater use of counter-cyclical funds, counter-cyclical tax credits, regionalizing tax burdens, regional development corporations and Federal Loan programs are all part of such an effort.

Basically, only Federal stimulus will ultimately reverse the downward trend of the economies of our older cities. Major efforts are needed to break out of the vicious downward cycle of cutbacks followed by economic erosion followed by more cutbacks. Only massive shifts from welfare to employment can break the cycle of poverty and hopelessness in the ghetto. The truly important abortion issue in this country concerns those lives that are aborted after birth, by coming into an environment that offers no hope for social or economic improvement. Life in the ghetto can be abortive after birth. In a world where
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Address Given By
FELIX G. ROHATYN

BEFORE
The New York Chamber of Commerce and Industry
September 21, 1976
Labor Day has come and gone, so has Op-Sail and the Democratic Convention. The summer was good for the image of the City and for morale. Millions of visitors from all over the country came and were impressed, and had occasion close up to view the City's incomparable assets. Although the psychological lift this gave us was a welcome change from the previous year of gloom and crisis, it would be folly to think that our problems are behind us and to ignore the fact that we still must grapple with deep and fundamental flaws that must be corrected if the City is to regain its vitality.

In order to judge what we should be doing, it is worth looking backwards only for the purpose of seeing which of the problems have been met, where progress has been made, and where much remains to be done.

As you know, one can categorize the City crisis as falling into the following categories: a) those problems due to the City's failures; b) those problems due one way or another to the State; c) those resulting from Federal actions; d) those resulting from general economic and social currents beyond anyone's control. Where do we stand with respect to these four categories?

The City's failures, in my judgement are of two kinds, namely, the mismanagement of programs and the mismanagement of finances.

With respect to the mismanagement of programs, it is worth noting that welfare costs increased from $520 million to $2.8 billion in ten years, with the City's share presently standing at $800 million. Leaving aside the question of Federal responsibility for financing, which I will revert to later on, the need for a major management reorganization of the program, as well as a significant economic development effort to shift people from welfare to employment, is as acute today as it was a year ago.
The Board of Education has seen enrollment unchanged in the last decade, while costs have ballooned from $1 billion to $2.7 billion. While this has occurred, there is little question that the quality of education has declined. The need to reorganize the educational structure of the City is talked about at length but very little or nothing has been done about it.

The Health and Hospital Corporation has seen its budget increase during the decade from $340 million to $1.4 billion. The City's share has gone from $190 million to $430 million, while the utilization rate has gone steadily down. The need to look at the delivery of health care as an overall system, including both voluntary and municipal hospitals, and to reorganize that system from top to bottom, is glaring. A patchwork labor settlement with respect to municipal hospitals was reached recently, which gave everybody involved, the City, the unions, and the public, a sense that some solution to the problem had been found. This is cruelly misleading since all that was done was to buy a few months time, and unless some dramatic change in terms of the approach to the problem and to the management of the system is arrived at, the same problem will be staring everybody in the face in January. It will be worse in one respect since so many people now think that a solution has been found.

In the area of housing, little or nothing has been done. Everybody is shying away from the issue of rent control, although that issue has to be met sooner or later. This is not to say that I am in favor of simply abandoning rent control, but some modification to the system surely must be made, and there is not a glimmer in sight of any new approach to the problem.

There has been progress however, in my judgment in two major areas; one is financial and fiscal management, and the other is labor costs. With
respect to labor, although a great deal still remains to be done, wages were frozen, a policy of no wage increases; of reduced fringe benefits; of cost-of-living adjustments payable only out of measured productivity, is in application city wide. The proof of the pudding is still in the eating, but the acceptance of the policy and the need to create guidelines and structuring to make it work, seem to me to be a conceptual breakthrough. Through layoffs and attrition the work force in the last year and a half has been reduced by some 50,000 people without serious labor disturbances, and without crippling service reductions. This, in itself, is a major feat. In Albany a small beginning has been made on the subject of pension reform, which weak and possibly inadequate as it may be, still breaks some new ground and may provide a stepping stone to further change.

In the fiscal and financial area we were faced last year with $5 billion of short term debt with no market available, a requirement for an additional $2 billion in the current year, and a so-called long term City debt of about $6 billion with an average life of approximately five years. The hidden deficit was about $3 billion and about $3/4 billion of expenditures were buried in the capital budget.

The debt and deficit structure of the City was a result both of its own fiscal and financial mismanagement and of an astounding willingness on the part of the financial community to provide excessive and unsound financing. The State, during that period, participated fully in the approval of burdensome pension agreements, as well as setting a miserable example with the reckless use of moral obligation bonds. In addition, the State did not participate adequately in the funding of the City University system as well as in the cost of the Court and Correction System.

During the same period the Federal government, pursuing a deliberate policy of Southern and Western development, as well as a policy of suburban vs. urban development, watched our wealth being drained away and
sat by while national poverty moved from the South to our urban areas and saddled our local communities with a disproportionate share of the burden.

To stop the uncontrolled financial hemorrhage to which the City was prey, a series of drastic steps, all of them painful, some of them counter-productive if continued for long, were taken.

1) $500 million in taxes have been imposed.
2) A drastic wage policy as well as a massive reduction in the labor force has come into being.
3) $9 billion in financing has been obtained and a moratorium on $1 billion of City notes is in effect.
4) The State lent the City $750 million, increased its funding of City University and created the Emergency Financial Control Board.
5) Tuition was imposed at City University.
6) The transit fare was increased by almost 30%.
7) Two new deputy mayors and a new budget director were appointed by the Mayor.
8) A credible set of facts and figures began to be produced regularly by the City and new accounting systems were put in place.

As a result of these measures the financial position of both the City and State have been improved.

1) The State, which last year at this time was totally out of the financial markets, was able to complete its $4 billion spring borrowing program as well as refinancing the main State agencies.
2) The Housing Finance Agency sold $150 Million worth of bonds last week.

3) Last week MAC repaid to the State the first $250 million of the State's investment in the City.

4) The prices of MAC bonds in the marketplace have steadily improved in price.

5) The Federal Loan program was continued into this year and is on track.

These events, together with continued City retrenchment and reduction in its massive deficit, are, in my judgment significant, and possibly a dramatic change.

It is obvious, however, that a great deal still has to be done.

The financial situation that we are facing is still one of great fragility. If the current plan stays on schedule the City will have a $6 million cash balance at year end and obviously this does not permit any slippage in the plan. For instance, a delay in the sale of Mitchell-Lama mortgages scheduled for the spring could create serious cash flow problems.

Whether the budget of the City can be balanced in fiscal '78, considering the continued lag in the City's economy, without at the same time tearing the City apart, is open to question. The reduction in services as a result of layoffs and attritions will soon reach a critical level. Additional layoffs, beyond those in the fiscal plan are becoming counter-productive by creating additional unemployment costs and a drag on the economy.

Massive management improvements can obviously still be made. The so-called independent agencies (Health & Hospital, Board of Education, etc.) should be brought under direct City control and independent management reviews of each department should be made regularly and made public.
One cannot ask for sacrifices and productivity from the labor force and acceptance of reduced services by the public without trying to get the most mileage for the money with the best possible management. It goes without saying that there are issues beyond efficiency in Education, Health, Social services, etc., and these issues have to be faced by those responsible, but saying that management is antithetical to social consciousness is the ultimate cop-out. When there is no money for the luxury of featherbedding, amateurism and political cronyism, then efficiency is the only weapon available to produce the savings required to maintain an adequate level of services.

Incredibly, the call for bankruptcy is still heard from both ends of the political spectrum. Unknown bond traders leap out of a richly deserved obscurity to grace the pages of the New York Times with articles about the delights of default. Liberal politicians see it as a way to wipe out the debt. The Wall Street Journal sees it as a way to wipe out the unions. In fact, it is only a way to wipe out the City. It is depressing that still today, after all we've been through, sophisticated people don't understand that one cannot wipe out the debt, that there is no need to kill the unions, and that only chaos, as a result of reduced services and a fatal triggering of a business exodus would result from bankruptcy. The fatal wounding of the State's credit as well as the blow to the banking system and the general economy, are additional factors.

A considerably more cogent argument can be made for stretching the three-year fiscal plan. This argument perceives that it took several decades for the present City situation to have been created, and that three years is too drastically short a period for it to be absorbed. I do not believe that a stretch out of the fiscal plan is needed. The deficit should not be carried beyond June 1968. What is needed is a stretch out
of the City's debt structure by completely refinancing the City and MAC debt on a longer term basis, thus reducing the excessive current debt service burden and permitting the City to get into balance on schedule.

Inept financial management, at best, for which the financial community deserves at least as much blame as the City, created the impossible structure we faced last year, to say nothing of encouraging the use of short term notes in the financing of Mitchell-Lama construction. MAC, very painfully, and at great cost, refinanced about $4.5 billion of the short-term debt on about a 10-year basis, with $1 billion of City notes still in moratorium. City long-term bonds are a misnomer because their average maturity is approximately five years and currently $1-1/2 billion a year is dedicated to debt service on City bonds alone. MAC, as you know, is serviced by the sales tax; City bonds by the real estate tax.

All of the existing debt, both MAC bonds and City bonds, should be refinanced on a 20 to 25 year basis through a Federal Government guarantee program. This would have the following advantages.

1) With respect to MAC, for instance, 7% interest rates and 20-year maturities, through Federal guarantees, would relieve the City budget of approximately $200 million per annum, and should be sufficient to get the City budget into balance on schedule with further economies and sound management.

2) A refinancing of City bonds with similar maturities and interest rates would permit as much as a 20% lowering of the real estate tax, providing significant economic stimulus.

3) Federally guaranteed taxable bonds would provide substantial U.S. Treasury income, up to now unavailable.

For example, if a Federally guaranteed program insured $5 billion of MAC bonds, and if these were sold to the public at 7% interest, a
30% tax rate and a 1/2% annual guarantee fee would produce for the Treasury, $2 1/2 billion or 50% of the total amount of the guarantee over a 20-year period.

Furthermore, a Federally guaranteed program for MAC, an extension of the Federal seasonal loan program and a balanced City budget should permit the sale of City bonds without Federal guarantee through the banking system.

Once the budget is in balance as a result of debt refinancing and the continuous current economies, the ultimate assumption by the Federal government of the local share of welfare costs, should provide the City with significant funds for vitally needed services as well as enabling it to embark on a significant program of economic development. This program, both at the City and State level, has to include broad tax reduction to make us more competitive with neighboring states and regions.

In addition to such a City and State Economic Development program, we must continue the regional efforts started last May by Governor Carey and Governor Byrne, which resulted in the creation of the Coalition of Northeast Governors. This group is now working on a three-part economic program for our impacted region:

1) A program of Federal counter-cyclical revenue-sharing funds as well as changes in Federal formulas.

2) Counter-cyclical investment tax credits or accelerated depreciation rates related to economic impact.

3) A Regional Energy Development Corporation, with Federally guaranteed bonds, to undertake large-scale regional projects aimed at producing jobs and reducing energy costs and use throughout the region.

In addition, the Coalition will undertake joint political action to redress a situation which saw the North Central and Northeast states
pay to Washington $43.7 billion more in taxes than they received back, while
the Sun Belt was getting $31 1/2 billion more than it paid.

The creation and retention of private jobs has to be at the center
of any City and State development policy. The New York Economic Council,
headed by Governor Carey and Mayor Beame has to function regularly and
give direction to the private and public sectors. Although New York will
probably never regain its previous manufacturing businesses lost to other
parts of the country, that does not mean it should not try to do everything
in its power to keep what we have.

New York has incomparable assets as a center of finance, entertainment,
culture, communications, international trade, and a broad spectrum of small
and medium sized businesses. The choice here is not between a convention
center and day care centers. The challenge is to create a balanced
economy where recurring tax revenues are sufficient to pay for the
required level of service.

Times have changed and the clock will never be turned back. People
are willing to make sacrifices if they understand why, and if they can
see that everybody else is sacrificing. In 1940 Charles de Gaulle spoke
for a beaten France and gave her dignity. Someone must speak for New York,
to her own people, to the region it belongs to, and to the rest of the
country which, whether it knows it or not, cannot function without this
City.
DRAFT REMARKS

for

Felix Rohatyn - MAC Chairman

Conference on a National Economic Development Policy
It is a privilege to be with you this morning.

It is particularly a privilege to appear as the keynote speaker at a conference on a national policy for Urban America. It would be more than presumptuous of me to suggest in total what such a policy might be, but it is indeed a proper subject for a full conference or even a series of conferences because I believe that if we cannot govern our cities we cannot govern our country.

I cannot take seriously the talk of those, particularly in this political year, who suggest that cities are outmoded or anachronistic.

I find myself agreeing more with Eric Hofer, quoted in a note on this program that "Not a single human achievement was conceived or realized in the bracing atmosphere of steppes, forests, or mountain tops. Everything was conceived and realized in the crowded, stinking little cities of Jerusalem, Athens, Florence, Shakespeare’s London, Rembrandt’s Amsterdam. We will decay, we will decline if we can't make our cities viable. That’s where our destiny will be decided -- in the city." Hofer concludes, and I believe he is correct, "We neglect cities at our peril."

New York's problems like those of most large cities are complex, pervasive and formidable. They are not amenable to quick solutions that are tied to the tenure of a political administration; or to the promises made to gain public office.

Many of our older American cities are suffering from the same ailments. The symptoms are similar to New York's. Indeed, someone has said, that"all cities say the same, New York simply says it first." I would only add that New York is so large
that it is almost a caricature of what is happening in the country.

I would add parenthetically that our newer American cities, like Houston, Dallas, and Phoenix, cities which in effect have the power to expand their boundaries, to follow the taxes, if you will, are doing just fine.

There are no simple solutions to the problems of our older American cities. There are no mystical answers to the doubts which concern us. There are no magical codes to the questions which puzzle us. Perhaps I can share with you some of the thoughts I have had over the past year that will in some way suggest some of the policies and programs we must advocate on all levels of government, if we are to survive and flourish.

Let me review where we have been.

The numbers are staggering. In total MAC refinanced almost $9 billion of City debt. Because of an ever increasing series of borrowing over the past few years the City of New York had become by far the largest issuer and redeemer of debt in the public market place. It was exceeded by only a single borrower; the federal government itself. In an almost final gasp in fiscal 1975, the City issued more than $9 billion of debt and redeemed more than $8 billion. These amounts approached in size the City's total expense budget. They were so large that they were beginning to de-stabilize the nation's total municipal credit markets.
In effect New York City had become a credit junkie. The reasons are many and complex. There is little sense going over them again. What MAC did was to put a "cap" on the total debt service by funding most of the City's short-term debt and current deficits. MAC, largely in cooperation with the banks and pension funds of the municipal credit unions raised $8.4 billion of new money and exchanged $900 million of the City's short-term debt. The average interest rate was 7%. The average maturity, 12 years.

It was a monumental task - accomplished with the committed and responsible leadership of our municipal unions and our banking community.

In exchange the City of New York agreed to draw up and implement a three-year financial plan which would reach a balanced expense budget by fiscal 1978, and which would not exceed the available financing resources during that period. The City also agreed to accept uniform municipal accounting principles and to phase expense items out of the capital budget over a ten-year period.

Relating it now in an almost matter of fact fashion does not suggest the frustration and anguish that was part of almost everyday life for many of us six months ago. It does not suggest the commitment so many made to maintain the financial stability of the City.

To avoid a default this City has experienced a belt-tightening unlike any in the past.
25,000 workers have been laid off
15,000 jobs remain unfilled as municipal workers have left

City employment

These payroll and fringe benefit savings add up to $791 million. Municipal workers have voluntarily agreed to a three-year wage deferral.

City managers will not receive increases.

City property owners are paying increased real estate taxes. Productivity is now a negotiable item in collective bargaining agreements.

These are not simply abstract, cold, unreal figures. Real people in communities throughout the city are feeling these economies in real ways.

We're all being asked to bear the pain.

Four hospitals and 15 health centers are closed. Drug treatment programs are curtailing services as heroin addiction threatens us once again.

28 day care centers have locked their doors.

The list grows longer.

But it was clear to all who were concerned from the beginning that the financial restructuring could not be done without pain. We said it in the beginning and I repeat it again -

15 years of fiscal irresponsibility cannot be turned around in a painless wink.

Fiscal soundness cannot be restored overnight. Nor can it be restored without sacrifices.

We must deal with the pain and find ways to alleviate it. Bankruptcy is not an option.
The idea that the City should go into voluntary bankruptcy has been discussed publicly. There seems to be a sense on the part of those who advocate that the City would somehow or other solve its problems with less pain if we chose that method. Ken Galbraith has suggested that the City might have been living beyond its means but that it is not living beyond its needs. I agree.

But how can the leap be made to voluntary bankruptcy as a solution baffles me. The suggestion is that this course would somehow curtail current cuts. The common thread for all who argue bankruptcy as an option is that New York could avoid pain if it chose voluntary bankruptcy. Somehow, they argue, things would be easier if we went into receivership.
At bottom line again the suggestion is that the burden of the debt would be lifted if we simply refused to pay our obligations. There is a childish sense that a good father, a beneficent federal referee would make it all whole again, that he would excuse the obligation to pay our present debt. To call this kind of a solution shortsighted and thoughtless is to give it all the breaks. It is the kind of fiscal naivete that is partially responsible for getting us into the position that we are presently in.

Corporations go broke and dissolve – indeed, this happens frequently. But cities must continue to operate. They must continue to provide service. But they must in the final analysis satisfy their creditors.

Bankruptcy will not buy time. It will only buy trouble. It is not an experiment worth trying. It would be an admission of defeat that I don't think we ought to make. It would be a final signal to those corporations which are considering a move that we do not have the will nor the intelligence to handle our finances in a responsible fashion. The trickle of corporations leaving the city and the region would increase to a torrent. The tax base which is already in trouble would decline even further. Unemployment which is one of our key problems would increase and the result would make an almost impossible situation totally unworkable.

Certainly in a default the monied interests would suffer. But their pain would in no way approximate the anguish and pain of the poor people in this city. Wealthy corporations can run. They have the resources to recoup. The middle class
is caught in the middle. The poor have nowhere to go. The options available to the poor are few and hardly pleasant.

And, totally absent from the analysis of those who advocate default is any sense of the relationship between the City and the State. A default by New York City would also place the State and its agencies which have had serious financial problems in even greater peril.

Those who argue for a stretch-out, it seems to me, offer a more rational and more manageable solution to the problem.

There is clear logic in their argument. It took 20 years of political and fiscal folly and federal neglect to get us where we are. To compress the cure for two decades of disease into three years is unreasonable and unworkable therapy.

It is difficult to dispute the argument. But the major problem is that we only have the financing for a three-year plan. Whatever the difficulties, a stretch-out is an option far more reasonable in my judgment than bankruptcy.

But even a precisely figured and brilliantly executed financial plan be it for 3 or 10 years will not restore the economic life of the city.

It simply provides the framework to avoid a bankruptcy. It buys time during which we can begin the process of long-range economic therapy - therapy that must include major federal commitment.

This city was in decline long before the fiscal crisis or the implementation of the three-year plan. The crisis itself is only symptomatic of long-term, deep-seeded problems.

The Federal Bureau of Labor Statistics estimates that the city lost more than 1/2 million jobs since 1969, including 100,000 of
which were lost in 1975 alone.

I know that New York has always lost jobs. Jobs and companies have always moved around this region. But the City was also always the incubator of new industry. The distressing reality is that the incubator function has stopped.

15 years ago New York City had more industrial employees than any City in the world. Nearly 25% of the total workforce in 1960 or 1 million worked at the production of goods: 80 million in food trades, 250 million in the garment trades, almost 20 million ground lenses scientific instruments.

In New York City there was almost nothing that couldn't be bought or sold or made or put together. That vital life is disappearing.

The results of these losses -

The median family income is

We now have the highest percentage of people over 65 in the nation.

The number of families below the poverty level has increased by 8%. In short we are developing the kind of demographic and population mix that was typical of rural Georgia or dust bowl Oklahoma 40 years ago.
What is most clear to me is that the federal government must develop a positive policy on cities.

Till now federal policy has largely been one of "benign neglect". There have been federal programs for cities; but they have largely been remedial. There has not been an integrated, thoughtful, national position on urban regions. The thin solvency of most of our older cities will impose even harder burdens on all of us if we do not develop a federal policy for all of our cities. The federal government must begin to consider some of the basic causes of the city's problems and develop some of the solutions. Cities can only do so much for themselves. State governments can only help up to a point. I do not wish to exonerate inept municipal management or to suggest that we revert and become fiscal junkies seeking federal assistance every time a new problem arises.

But there is no reason why we can't make our case for a more equitable share of our own resources from the federal government at the same time that we restructure a more efficient municipal administration. Both activities can go on at the same time.

Efficiency in government is not antithetical to a humane and compassionate city. Indeed, it may be the absolutely necessary handmaiden in a period such as this.

Indeed our elected leaders have the responsibility to develop specific programs and administer them justly and efficiently. This city has been badly managed for years. But much of what the State and City combined can do, in the words of Professor Brian Berry, amounts to imitating the man with the garbage can who follows the elephant into the circus ring and follows him around cleaning up the mess. The finest tuned bureaucracy
can only do so much if it doesn’t have the proper resources.

For 30 years this national government has had a deliberate and developmental strategy for the South and Southwest, the Rim, if you will. It was a policy well conceived and brilliantly executed. It was the decision of New Deal leadership to redistribute our national wealth to the areas which were not sharing equitably in the productivity of the entire country. It was a policy which I believe was correct and just. And most importantly it was also a policy that was carried out at the proper level of government. Parenthetically, I believe that much of our present problems in New York arise from the fact that the city has usurped or rather filled the void left by the federal government. It is not a proper function of cities to redistribute wealth. They do so at their risk. Policies of redistribution must be determined at the federal level.

But my main point is that the federal government has the power and resources to make major change in America. Part of the reason that the major cities from the Great Lakes to Maine, indeed all the large and not so large cities of the Northern crescent are steadily losing jobs, population, industry, payrolls, bank deposits, credit ratings, and tax bases is because of calculated and determined policies developed, advocated and carried out at the federal level.

I add, that if federal policy worked once, it can work again. I don’t think we have much chance with this present administration. Indeed, I am further chagrined because I do not believe that any of the presidential candidates have at this point given any significant indications that they have any substantive ideas about changing urban America.
At the same time that our northern cities were declining, the cities and areas of the southern rim or southern tier from Virginia to California were blossoming with new residents, new plans, new equipment, and new investment. Almost while we weren't looking they have gained a new prominence in the nation. The reasons for their new prosperity are many: good climate, cheaper labor and cheaper power. But certainly, the major reason has been the extraordinary investment of public monies in the region. These monies have been kept flowing by
an active and senior congressional delegation; a delegation that has incidentally increased by 25% in 30 years.

While the rim was prospering, this entire region declined. I do not feel that the northeast is in any immediate danger of losing its pre-eminent status as the cultural, financial, and communications center of the nation. But, there are signs that major segments of American life will continue to relocate out of the region. There are disturbing signals that go beyond the boundaries of this city and suggest that what has manifested itself most obviously in New York City is really only symptomatic of what is happening in the region. Again, we are most familiar with the problems of the city, but they are only part of a larger trend.

The northern giants of Philadelphia, Detroit and Chicago have also experienced declines in the most pertinent indices over the last five years. From 1970-74 the census showed a growth of only 1.8% in the Northeast and North Central states. During the same period the national growth average was slightly more than 4% and the average in the south and southwest was more than 8%. Pittsburgh lost 157,000 people between 1950-70 and has dropped in population from 9th to 12th among metropolitan regions. In the same period, Philadelphia lost 122,000 people. The state of Pennsylvania lost 400,000 people in the 60's. It was the largest loss suffered by any state during the period.

More important than this has been the total stagnancy or decline in such economic indicators as employment, bank deposits and tax base. The tax base is disappearing with the out-migration.
Center cities are increasingly left to people who no longer have an economic function. To a large extent, federal policies are responsible for the problems we face. We can build a bureaucracy as finely tuned as a rare Stradavarius, or as precise as the finest Swiss watch, but we will still be spinning wheels if we do not receive a just share of federal assistance. Because in the final analysis, we do not have the power or resources to change what must be changed.

The federal government has changed the make-up of an entire section of the country by determined policies. In federal fiscal 1973, Mississippi received back $2.34 on the tax dollar, Virginia $1.24, South Carolina $1.39, Alabama $1.34 and California $1.06. In contrast, New York received 47 cents, Pennsylvania 64 cents, Ohio 51 cents, Connecticut 51 cents, Massachusetts 82 cents. This is a pattern that has remained essentially unchanged for 15 to 20 years. Incidentally, these figures assume a certain kind of irony when you recall President Ford’s platitudes about bailing about a profligate New York.

In a political history that has included oil depletion allowances, cattle loan guarantees, disaster loans of all shapes and sizes, certainly our requests for a more equitable return on our own production is not unreasonable.

We have been paying more than our share to the rest of the country for years. The federal government can reverse that policy and now begin to support the city of New York and other
major cities of the Northeast in a more equitable fashion. New York City subsidized the federal government. This city has 3.6% of the nation's population. Yet, we provide the federal government with 7.4% of its income tax collections alone. We receive back 5.5% of the total federal aid allocated to local and state governments. The difference between what we give and what we receive is close to a billion a year. Combine that with the savings we would make if the federal government picked up the cost of welfare and not only would we eliminate major portions of the deficit - we would have a surplus.
With all of our new efficiencies, that is, laying off workers, freezing wages, eliminating capital construction, raising taxes we are in danger of institutionalizing recession. We must take these steps to close the budget deficit.

But, the other reality is that laid off workers spend less, home owners paying higher taxes spend less, decreased spending cuts down revenue, decreased revenue cuts down services, decreased services encourage people to leave. It is not even a vicious circle. It is a downward spiral.

John Banting, the Chairman of the First Pennsylvania Corporation has suggested a plan which I believe must be adopted in some fashion on the federal level if any long range therapy is to be effective and if this cycle is to be countered. He argues that the federal government must create a mechanism which in effect allows the city to run a budget deficit. President Ford is allowing the federal deficit to increase and linger long enough to stimulate an economic recovery. Cities cannot do the same without federal legislation. Banting suggests that the feds adopt a law subsidizing through the existing revenue sharing mechanisms, deficits of up to 15% of the annual expenditures of a city when unemployment in the city exceeds 6%. It is an interesting idea and I believe it, or some variation must be adopted.

The Federal Government must assume additional costs of welfare.

One of every seven persons in our city is on welfare. The combined cost of welfare, that is direct welfare and medicaid costs, is 1.4 billion of city raised tax levy money. The city's direct
contribution to welfare is $800,000,000 annually. If the federal government were to absorb that cost, and in justice they should, a major portion of our deficit would be wiped out. That $800,000,000 figure is only the direct cost of welfare. It does not include the additional costs or services to people who receive public assistance. It does not include the costs of collecting garbage. It does not include the cost of police or fire protection. It does not include the costs educating children. Perhaps the proper welfare solution that would have the most long ranging effects would be a system that provides for a guaranteed annual income.

New York can no longer absorb the costs of rehabilitating and educating and housing the poor. The rest of the country must absorb and honor their responsibility in that regard. The failure of our economic systems are national failures. The nation must deal with them.

The states of the region must begin to develop certain regional policies so that the competitive economic chaos that offers no future to anyone stops. If the economic Cannibalism that has become common place continues, we will succeed in only destroying the ecology and economy of the whole region. We cannot continue to live on economic islands, piranhas desperately fighting for the remaining pieces of economic flesh.

The fate of New York City is inexorably bound up with the future of the entire metropolitan region and the future of the counties surrounding New York City are inexorably bound up with
the future of New York City. The old boundaries must be extended.

A major part of the reason for New York's problems presently is based in large part on the problems created by the mindless economic development in the region over the past decades. We must find ways to eliminate regional disparities so that the mindless and ultimately destructive competition does not continue. The states of this immediate region and the neighboring states must begin to explore the possibility of new regional arrangements which will provide capital for commercial and industrial reconstruction of underdeveloped areas. They must in concert seek the solutions to the present and future needs for more and less expensive energy. Call it what you may - a Northeastern Reconstruction Finance Corporation, a Regional Development Authority, but some sort of regional corporation with seed capital provided by the state and bonds guaranteed by the federal government could be the start of what is finally needed, namely a Marshall Plan for the cities.

Only federal stimulus can reverse the downward trend of urban economies. Only reconstruction and industrial stimulus can rebuild our tax base. Only massive shifts from welfare to employment can break the cycle of poverty and hopelessness of the ghettos.

Am I clear? I believe that this city and others can do only so much to solve their major problems of poverty. They are problems which are national in origin. The resources to solve them must come from that level of government.

New York City has done a disproportionate amount of the nation's work. What America did for the 19th century European
immigrant, New York City has done for American immigrants of this century.

Where the nation has failed, we have tried to succeed, often in vain. We can do little more without assistance.

I lay major responsibility for saving our older cities with the federal government, but I do not want anyone to think that I believe the role of this city is to behave like a fiscal junkie -- passively nodding, simply awaiting the next federal fix. There is plenty to do in the meantime. We can go cold turkey. We must put the municipal house in order. We need bold municipal and political leadership which will creatively and thoughtfully develop a new agenda for the next years. This leadership must be bold enough to say some hard things.

It is becoming increasingly more difficult for working people to survive in this city. The same is becoming increasingly true for the middle management class which staff our corporate headquarters.

Without either group, the city cannot grow. Indeed, talk of growth may be naive. Survival might be more to the point.

We must give priority to an agenda that will make New York attractive as a place to live and work for these people.

If we don't, we will have to face future announcements of new corporate moves which will further decrease our sources of wealth.

There are many reasons why corporations abandon the city for the surrounding suburbs. Many are, in my judgement, for personal rather than professional reasons. Check any move and you will inevitably find that the corporate move is most often in the direction of the home of the chief executive. While I believe,
that these moves will be seen as social and environmental disasters - it is also true that these relocations are inspired by a search for a better quality of life. There is no sense denying it. It is becoming increasingly difficult to live in New York.

If is difficult to find adequate housing at a reasonable rate. It is difficult to find public schools that do the job. People have legitimate fears about safety.

We need a political leadership that is not afraid to talk about the need for a middle class agenda. If we don't have it, we will soon have a city which will be a wasteland.

Until 40 years ago, this nation was a leader in social revolution. Yet, we now enter our bi-centennial year with no solutions for our cities. Indeed, in the middle of our bi-centennial presidential election, we hardly hear discussions about what I believe is our major national failure. If we cannot integrate our cities into the rest of the country, our system will have failed because we will inevitably have major social upheaval.

Our national defense budgets will not keep Italy from going Communist nor France from voting Socialist.

The third world watches us carefully. Will we on this 200th anniversary translate those earlier commitments about equality and dignity into deeds that make a difference for the poor and dispossessed. Those questions must be answered in this coming decade. We can begin our domestic and our foreign polity in the slums of Cleveland, Brownsville and Watts.
This nation once fought a war because our leaders felt that we could not survive half slave and half free. We face another catastrophe if we really believe that we can survive half city half suburb.

In the Great Gatsby, F. Scott Fitzgerald referred to that netherland between the country estates of the rich and the city from which they derived their wealth as the "valley of ashes." Surely we have learned by now that there are no sanctuaries. Ashes are carried on wind.

Until our urban regions cohere and function efficiently together, only disorder will plague us.

The choice remains ours, for a while.