REMARKS BY MAYOR EDWARD I. KOCH
CITIZENS BUDGET COMMISSION ANNUAL DINNER
WALDORF ASTORIA HOTEL
WEDNESDAY, JUNE 15, 1983

THANK YOU, LARRY HUNTINGTON.

GOOD EVENING.
TONIGHT, WE ARE HONORING GOVERNOR MARIO CUOMO. WE ARE SIX MONTHS INTO HIS ADMINISTRATION. ALL OF THE COMMENTARIES THAT I HAVE SEEN AND MY OWN PERSONAL OBSERVATIONS ARE THAT ON EVERY OCCASION WHERE A DECISION WAS CALLED FOR AND LEADERSHIP REQUIRED HE MADE THE RIGHT DECISIONS AND DISPLAYED THE LEADERSHIP NECESSARY TO WIN THE BATTLE.

THE CITY OF NEW YORK OBVIOUSLY WAS MORE THAN AN INTERESTED BYSTANDER IN THE BUDGETARY NEGOTIATIONS OF THE STATE LEADING TO WHAT WE ALL HAVE REFERRED TO AS AN EXEMPLARY BUDGET -- BROUGHT IN AHEAD OF TIME, BALANCED AND FAIR TO THE CITY OF NEW YORK. AS MAYOR OF THE CITY OF NEW YORK I HAVE AN OBLIGATION TO WORK WITH WHOMEVER THE GOVERNOR IS. IT IS PARTICULARLY IMPORTANT, HELPFUL, AND FROM A PERSONAL POINT OF VIEW, PLEASURABLE, TO WORK WITH SOMEONE WHO IS DOING A GOOD JOB AND IS A FRIEND OF THE CITY.
TWO YEARS AGO, WHEN I WAS HONORED TO RECEIVE THE COMMISSION'S AWARD FOR HIGH CIVIC SERVICE, I USED THAT OCCASION TO POINT TO THE DRAMATIC IMPROVEMENT IN THE CITY'S BUDGET OUTLOOK. TONIGHT I WOULD LIKE TO TOUCH ON THAT SUBJECT ONCE AGAIN. AFTER ALL, ISN'T THAT A NATURAL DISCUSSION TOPIC BEFORE A COMMISSION THAT HAS BUDGET AS ITS MIDDLE NAME?

BY NOW YOU HAVE NO DOUBT HEARD THAT NEW YORK CITY IS ABOUT TO END ITS CURRENT FISCAL YEAR WITH A BUDGET SURPLUS OF OVER $500 MILLION. NOT ONLY IS THIS THE LARGEST SURPLUS THAT THE CITY HAS EVER RECORDED IN ITS 350 YEAR HISTORY, IT IS ALSO THE LARGEST SURPLUS RECORDED THIS YEAR BY ANY STATE OR CITY IN THE UNITED STATES - BAR NONE! AND I MIGHT ADD IT COMPARES RATHER FAVORABLY WITH THE $2.8 BILLION BUDGET GAP THAT WAS ORIGINALLY PROJECTED FOR FISCAL 1983, FOUR YEARS AGO.

YET, DESPITE ALL THE GOOD NEWS, DESPITE THREE YEARS OF CONSECUTIVE SURPLUSES, THERE ARE THOSE WHO SAY THAT THE CITY STILL FACES STRUCTURAL IMBALANCE. WAIT TILL NEXT YEAR, THEY CONTINUALLY WARN, WHEN THE FISCAL ROLLER COASTER FINALLY DERAIS -- PLUNGING THE CITY INTO THE ABYSS OF FISCAL DESPAIR.

THESE ARE THE SAME PEOPLE, I MIGHT ADD, WHO MONTHS AGO WARNED THAT IT MIGHT BE TOO OPTIMISTIC TO ASSUME THAT THE CITY WILL EVEN BE ABLE TO BALANCE ITS FISCAL 1983 BUDGET LET ALONE HAVE A SURPLUS. SO, THEIR PROJECTIONS ARE SOMEWHAT SUSPECT. BUT, FOR THE MOMENT, LET'S FORGET THEIR TRACK RECORD AND EXAMINE THE FACTS.
STRUCTURAL BUDGET IMBALANCE, TO MY MIND, MEANS THAT EXPENDITURES ARE GROWING FASTER THAN REVENUES, THAT REVENUE GROWTH IS TOO SLUGGISH OR EXPENDITURES ARE WILDLY OUT OF CONTROL. LET'S SEE IF TONIGHT WE CAN'T DISCOVER THE ROOT CAUSE OF OUR "STRUCTURAL IMBALANCE"; THAT STRANGE BUT SO FAR UNDIAGNOSED MALAISE THAT AFFECTS FUTURE BUDGETARY PROJECTIONS BUT NEVER FISCAL REALITY.

THE FIRST STOP IN OUR LITTLE SEARCH IS THE SO CALLED ECONOMICALLY SENSITIVE TAXES. THESE TAXES SUCH AS THE SALES TAX, PERSONAL INCOME TAX AND BUSINESS TAX COMPRISE OVER 40 PERCENT OF THE REVENUES AVAILABLE FOR BUDGET BALANCING PURPOSES. WELL, SINCE FISCAL 1979 THESE REVENUES HAVE GROWN FIFTY PERCENT FASTER THAN INFLATION AND ARE GROWING AT A RATE CLOSE TO DOUBLE THE INFLATION RATE THIS YEAR - NOT BAD FOR A PERIOD OF NATIONAL RECESSION. BUT THAT GROWTH IS HARDLY SURPRISING WHEN YOU LOOK AT THE UNDERLYING STATISTICS ABOUT THE LOCAL ECONOMY.

AFTER ALL, DO YOU KNOW WHICH CITY HAD THE LARGEST GROWTH IN REAL PER CAPITA PERSONAL INCOME IN THE NATION IN THE LAST TWO YEARS? IF YOU GUESSED HOUSTON, DALLAS OR SAN DIEGO, YOU WERE WRONG. THE CORRECT ANSWER IS NEW YORK.

AND WHICH CITY AMONG THE NATION'S MAJOR CITIES HAD THE LOWEST INFLATION RATE OVER THE PAST FIVE YEARS? THE ANSWER, ONCE AGAIN, IS NEW YORK.
AND WHICH CITY HAS MORE THAN TRIPLED THE NUMBER OF FOREIGN BANKS DOING BUSINESS IN IT DURING THE LAST TEN YEARS AND NOW HAS MORE FOREIGN BANKS THAN THE NEXT SIX U.S. BANKING CENTER’S COMBINED? YOU HAVE PROBABLY FIGURED OUT THE ANSWER TO THIS ONE ALREADY.

SO CERTAINLY OUR ECONOMICALLY SENSITIVE TAXES ARE NOT THE SOURCE OF OUR STRUCTURAL IMBALANCE. LET’S LOOK FURTHER. SOME 34 PERCENT OF OUR REVENUES AVAILABLE FOR BUDGET BALANCING ARE GENERATED BY THE PROPERTY TAX. BUT THERE IS CERTAINLY NO LACK OF GROWTH IN OUR PROPERTY TAX BASE. OVERALL, PROPERTY VALUES IN THE CITY HAVE MORE THAN DOUBLED IN THE LAST SEVEN YEARS AND THE VALUE OF OUR COMMERCIAL AND INDUSTRIAL PROPERTY INCREASED BY 75 PERCENT IN THE LAST TWO YEARS ALONE.

IN FACT, WE HAVE CHosen NOT TO INCREASE OUR PROPERTY TAXES NEARLY AS MUCH AS PROPERTY VALUES HAVE Risen. AS A RESULT, THE TAX ON THE TRUE VALUE OF CITY PROPERTY HAS DECLINED BY ALMOST 40 PERCENT SINCE 1977 AND IS NOW AT ITS LOWEST LEVEL IN AT LEAST 25 YEARS. DO YOU KNOW ANY OTHER MAJOR CITY THAT HAS CUT ITS TRUE TAX RATE SO SIGNIFICANTLY IN THE LAST FEw YEARS?

LET’S LOOK FURTHER. THE OTHER AND FINAL MAJOR COMPONENT OF OUR REVENUE STREAM IS INTERGOVERNMENTAL ASSISTANCE FROM THE STATE AND FEDERAL GOVERNMENTS. HERE TOO, AS A RESULT OF THE POLICIES OF OUR GUEST OF HONOR, GOVERNOR MARIO CUOMO, AND HIS PREDECESSOR, FORMER GOVERNOR HUGH CAREY, AID HAS INCREASED SUBSTANTIALLY IN RECENT YEARS AND HAS HAD A SIGNIFICANT IMPACT ON THE CITY’S FISCAL PICTURE.
AND I EXPECT THAT SUCH AID WILL CONTINUE TO GROW IN THE FUTURE. AFTER ALL, WHY SHOULDN’T IT? CITY TAXPAYER CONTRIBUTIONS TO THE STATE TREASURY ARE EXPECTED TO GROW BY $600 MILLION IN THE NEXT STATE FISCAL YEAR. DON’T THESE TAXPAYERS HAVE THE RIGHT TO ASSUME THAT THEY ARE GOING TO GET SOMETHING MORE FOR THEIR MONEY?

SO MAYBE THE REVENUES ARE NOT THE PROBLEM. PERHAPS OUR EXPENDITURES ARE THE REAL PROBLEM. MAYBE OUR SPENDING IS SO PROFLIGATE THAT IT CONSUMES ALL THE FISCAL DIVIDENDS GENERATED BY OUR BUOYANT ECONOMY. ONCE, AGAIN, LET’S LOOK AT THE RECORD.

FROM FISCAL 1978 THROUGH 1983 OUR EXPENDITURES GREW BY ONLY TWENTY SEVEN PERCENT. THAT’S LITTLE MORE THAN HALF THE RATE OF LOCAL INFLATION AND ONLY ONE THIRD THE RATE OF FEDERAL SPENDING INCREASES.

AND DO YOU KNOW WHICH MAJOR CITY’S SPENDING INCREASED THE LEAST IN THE LAST FIVE YEARS? THE ANSWER, AGAIN, IS NEW YORK.

MOREOVER, NOT ONLY HAVE WE CONTROLLED DISCRETIONARY SPENDING BUT A SUBSTANTIAL PORTION OF OUR NON-DISCRETIONARY SPENDING GROWS AT A VERY SLOW RATE. FOR INSTANCE, ALMOST HALF OF OUR DEBT SERVICE AND PENSION COSTS RELATE TO THE EXCESSES OF THE EARLY 1970’S, WHEN PENSIONS WERE UNDERFUNDED AND DEBT WAS ISSUED FOR OPERATING EXPENSES. THESE PRACTICES HAVE STOPPED. AS A RESULT, DEBT SERVICE AND PENSIONS ARE BECOMING A LESS SIGNIFICANT PORTION OF OUR BUDGET EACH YEAR. IN FACT, DEBT SERVICE WHICH CONSUMED 24 PERCENT OF OUR LOCAL REVENUES IN MY FIRST BUDGET IN FISCAL 1979 WILL CONSUME ONLY 14 PERCENT OF
THESE REVENUES IN FISCAL 1984,

SO, HAVING EXAMINED BOTH REVENUES AND EXPENDITURES, WE HAVE COME TO THE END OF OUR SEARCH. BUT WAIT, IF REVENUES ARE GROWING FASTER AND EXPENDITURES SLOWER THAN THE INFLATION RATE, WHERE IS OUR STRUCTURAL IMBALANCE? WE HAVE FAILED IN OUR MISSION OF DISCOVERY, BUT PERHAPS IT'S FOR THE GOOD.

Perhaps it means that after all the trials and tribulations of the past eight years that the city can finally look forward to a period of fiscal stability.

Perhaps it means that after exceeding the expectations, not only of our critics but of our most fervent boosters as well, that we have finally achieved that most elusive fiscal goal: recurring budget balance.

Others apparently agree. Monday, the Citizens Budget Commission concluded that the 1984 budget, in addition to being sensible and prudent, "initiates a new four-year financial plan that holds out the promise of recurring budget balance." And last week the Municipal Assistance Corporation concluded that "the uncertainties that exist are manageable" and that the city, is now "conspicuous for its fiscal soundness."

Of course, we must maintain our vigil over excessive spending and resist those who wish to undo our hard won fiscal reforms.

And we will.
OF COURSE, WE MUST CONTINUE TO PROMOTE ECONOMIC DEVELOPMENT AND OUR REPUTATION AS A GOOD PLACE TO DO BUSINESS.

AND WE WILL.

AND OF COURSE, WE MUST OBTAIN RELIEF FROM OPPRESSIVE MEDICAID COSTS AND CONTINUE TO RECEIVE THE INCREASES IN STATE ASSISTANCE THAT WE ARE ENTITLED TO.

AND I KNOW THAT THE GOVERNOR WILL MAKE SURE THAT WE WILL.

BUT ACHIEVEMENT OF RECURRING BUDGET BALANCE MARKS A NEW STAGE IN THE CITY'S FISCAL DEVELOPMENT.

IT MEANS THAT OUR BUSINESSES WILL BE ABLE TO PLAN RATIONALLY KNOWING THAT THEIR TAX BURDEN WILL NOT BE GROWING.

IT MEANS THAT OUR FISCAL PARTNER, THE STATE OF NEW YORK, WILL BE SECURE IN ITS OWN PLANNING, KNOWING THAT ITS OWN FISCAL PLAN AND CREDIT RATINGS WILL NOT BE JEOPARDIZED ONCE AGAIN.

BUT MOST IMPORTANTLY, IT MEANS THAT THE PEOPLE OF THIS CITY WILL BE ABLE TO COUNT ON STABLE AND IMPROVING SERVICE DELIVERY WHICH THEY SO WELL DESERVE.

AND THAT, AFTER ALL, IS WHAT GOVERNMENT IS ALL ABOUT.

THANK YOU AND GOOD EVENING.
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Senator Proxmire, members of the Senate Banking Committee.

I am Edward I. Koch, Mayor of the City of New York.

It is a privilege for me to appear before this distinguished committee to present to you the case for continued federal assistance to my City. I have approached this hearing with a sense of great seriousness and urgency since the well-being of seven-and-one-half million residents of New York is in the hands of this committee. I thank you for this opportunity to be heard.

I. INTRODUCTION

In 1975, a serious fiscal crisis -- the product of long-simmering internal and external factors -- hit the City of New York. At that time, the City lost access to public credit markets; it became unable to obtain funds for operations through normal means, because investors no longer had confidence in the City's ability to meet its financial obligations.

Shut out of the credit markets, the City was forced to turn to unconventional sources - employee pension funds, special state mechanisms and, finally, the federal government. New control mechanisms were imposed and the City drew up a three year financial plan which imposed severe economies, service cutbacks and layoffs. Despite these efforts, the City has been unable to regain access to the markets.

In January of this year, the month in which I assumed office, we submitted a new four year financial plan to the Secretary of the Treasury. We have imposed additional economies; we intend to reduce our payrolls even further. We are determined to put our fiscal house in order, and we have, in fact, made much progress in doing so. Yet our fiscal crisis - our lack of credit access - continues unabated; the needs of our residents remain.

It is for this reason that I appear here today. In the testimony which follows, I will outline some of the causes of the 1975 crisis, detail steps taken to cope with its effects and present our proposals for further assistance. I believe that this historical approach will put our proposals in their proper context and also will serve to separate the internal and the external causes of the current crisis.
II. **BACKGROUND (1)**

Many observers—such as the Temporary Commission on City Finances and the United States General Accounting Office—have investigated the crisis with an eye towards uncovering the roots of the City's fiscal problems. The increasing cost of debt, the increasing cost of medical and public assistance, the cost of labor and retirement benefits—have all been identified as having played a role in precipitating the fiscal crisis. However, analysts of the crisis have also tended to agree that these issues are manifestations of more pervasive changes. Indeed an understanding of the demographic shifts and related social and economic changes that occurred in the past two decades are as central to understanding the causes of the crisis as are the changing ledgers of the government. Because these factors were major determinants of the cost of services provided by the government and its ability to finance its activities, understanding them is essential to understanding the City's response to the fiscal crisis and its need for continued Federal financing assistance.

A. **ECONOMIC AND SOCIAL FORCES OF THE 60's**

While the decade of the sixties was a prosperous one, it contained indications of the social and economic troubles that developed to crisis proportions in 1975.

During the sixties the number of City residents remained stable at 7.9 million and private sector job levels increased by 1.6 percent. The booming construction industry provided evidence that the private sector viewed the City in a favorable light—more than 100,000 privately financed housing units were built in the first half of the decade and by 1965 construction had begun or plans were announced for over 60 million square feet of new office space, including the World Trade Center.

The apparent stability in the population and in the job market however masked fundamental changes that were beginning to affect the economy. In the early sixties the migration of indigents attracted to the City by the hope of employment accelerated while the City's middle class population began to decline in response to the lure of more attractive housing and services in the surrounding suburbs, encouraged by Federal housing policy and facilitated by the interstate highway program.

(1) Most of the information contained in this section was taken from *The Message of the Mayor* in the Fiscal 1979 Executive Budget.
By 1970, the percentage of the population in need of subsidized or free social and health services had substantially increased and the percentage of elderly persons no longer participating in the workforce had expanded. Similarly, the numbers of poor people whose limited education and job skills restricted them to unskilled or low-skilled jobs grew while the number of manufacturing jobs was falling - by 180,000 between 1960 and 1970, thus dropping to 20 percent of the total jobs in the City in 1970 compared with 27 percent ten years before.

These problems were not unique to New York City but had become a common feature in the northeastern quadrant of the nation. The response from Washington was the Great Society and the "War on Poverty" in which the Federal government expanded existing programs and initiated new social experiments in the hopes of raising the standard of living of the poor.

This might have been manageable had the City maintained a stable economy with which to generate the taxes necessary to fund its share of the burden required by State and Federal law. However, with the onset of a nationwide recession in the 1970's, the City's economy went into decline. Between 1970 and 1975, the City lost 470,000 private sector jobs and the population declined by about five percent to 7.5 million persons.

Many factors appear to have contributed to this local business decline. High local inflation had its roots in the unprecedented expansion of public and private sector employment of the 1960's. When unemployment in the City fell below four percent, wages and prices leapt up to the point where the City's competitive position as the center of commercial activity was lost to other parts of the nation and the world. As employment declined, the need for social services grew, causing taxes to rise and thus increasing still further the cost of doing business in the City. The result was a further loss in local employment, with the unemployment rate exceeding 10 percent by 1975.

When the nation's economy began to show signs of renewed growth in the early 1970's, most analysts assumed that, as in past decades, the City would see a parallel upsurge. But there was no significant local recovery, only a slowing in the rate of decline.
The rapid increase in the municipal workforce in the 1960's was accompanied by an increase in labor union activity. During the period from 1960 to 1970, while full-time City employment grew 43 percent, membership in Civil Service unions grew by 300 percent. By 1970, three-quarters of the City's employees were union members and 90 percent were represented by unions in collective bargaining matters.

The net effect was to produce a City saddled on one side with a shrinking economy and tax base and on the other with rising costs of welfare and municipal personnel. The table below comparing the Budget to Gross City Product provides an insight into this combination of forces. The average growth of the tax levy portion of expense budget over the 15-year period was more than twice as great as the average growth in overall economic activity in the City as measured by the Gross City Product (GCP), suggesting that the City was spending beyond its means.

<table>
<thead>
<tr>
<th>Year</th>
<th>Tax Levy Budget</th>
<th>Five-yr. Avg. Annual Growth</th>
<th>GCP</th>
<th>Five-yr. Avg. Annual Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960</td>
<td>$1.75</td>
<td>- %</td>
<td>$33.38</td>
<td>- %</td>
</tr>
<tr>
<td>1965</td>
<td>2.63</td>
<td>9.9</td>
<td>43.15</td>
<td>5.9</td>
</tr>
<tr>
<td>1970</td>
<td>4.14</td>
<td>11.4</td>
<td>58.94</td>
<td>7.3</td>
</tr>
<tr>
<td>1975</td>
<td>7.25</td>
<td>15.0</td>
<td>72.47</td>
<td>4.6</td>
</tr>
<tr>
<td>Average</td>
<td>-</td>
<td>12.1%</td>
<td>-</td>
<td>5.9%</td>
</tr>
</tbody>
</table>

Comparison of the City expense budget to the GCP or resident personal income measured in constant 1960 dollars (rather than current dollars), as shown in the following chart, brings the problem into even more dramatic focus. Real personal income and GCP continued to rise until 1969 when both indices peaked and began to decline although the expense budget continued to rise almost without exception during the entire 1960-1975 period.
Economic Indicators Compared to the City Budget

With its revenue base declining but its expenses still increasing, the City recorded mounting budget deficits, accumulating to more than $5 billion by the end of the 1975 fiscal year.
These chronic deficits were compounded by the use of accounting techniques - such as including expense items in the Capital Budget - that are best described as "abuses". Equally as harmful, the City used short-term credit to pay for this continuing budget deficit; from fiscal 1966 to fiscal 1975, the City's short-term debt outstanding rose from $0.5 billion to $4.5 billion, accounting for 40% of total short-term municipal borrowings in the United States by the later year.

B. CHANGES IN THE EXPENSE BUDGET

In the fifteen year period 1960-1975, the City's expense budget more than quintupled from $2.5 billion to almost $13.0 billion, accompanied by major growth in the cost of operating agencies, personnel and pension benefits, health and social services, and debt as illustrated in the chart below.

Expense Budget Components

SOURCE: OFFICE OF MANAGEMENT AND BUDGET
1. Providing for the Poor

From 1960 to 1975, the greatest rise in City spending was due to growth in the welfare caseload and to the massive impact of the Medicaid program. Costs of welfare grants increased from $192 million in fiscal 1960 to $1,185 million in 1975. By 1975, more than 987,000 New York City residents, about 13 percent of the population, were receiving some form of public assistance and payments for public assistance amounted to nine percent of the entire City budget. Although the State and Federal governments financed 69 percent of that amount, the City paid the balance -- $366 million -- from its own tax revenues.

The largest welfare program was, and is, Aid to Families with Dependent Children (AFDC) which serves families where the children are deprived of economic support due to the absence, death, incapacity or long-term unemployment of either parent. The family is provided a "pre-added" subsistence grant, at a level established by the State Legislature, and a rent allotment up to a schedule of maximum rents established by the New York State Department of Social Services. The City also provides for the subsistence of 100,000 persons in the Home Relief program who are poor, generally unemployable and do not meet the eligibility criteria of the Federal AFDC program.

A recent study by the Temporary Commission on City Finances indicated that the $270 million paid by the City toward the cost of the AFDC program in 1975 greatly exceeded the amount of local revenues paid for AFDC by any other city in the country. Of the twelve urban areas in the United States with more than 10 percent of their population supported by the AFDC program, ten contribute no local revenues whatsoever to AFDC costs. The City of New York however is required to pay 25 percent of the total AFDC costs, twice the share required by the only other locality, Newark, that makes a local contribution. In fact, local governments in New York State pay about one-half of the welfare costs borne by all cities and counties in the nation.

Adding to the cost of welfare has been the expense of Medicaid. The passage of Federal legislation in 1966 establishing the Medicaid program was heralded as a major step in making comprehensive health care available to all people. The legislation authorized Federal financial assistance to states for payments to vendors who provide medical services to recipients of federally mandated Public Assistance as well as to certain other indigent individuals. Within broad Federal guidelines, each state designed its own program. In 1966,
New York State established the most comprehensive Medicaid program possible within the guidelines.

Although Medicaid has unquestionably improved a large portion of the population's access to medical care, it has also become the most expensive social welfare program in New York City. The Medicaid program in New York City began operating in May 1966. In its first full year of operation, $368 million was spent on Medicaid. By fiscal 1975, payments for Medicaid benefits in New York City amounted to $1.86 billion, 14.2 percent of the City's budget. Despite the fact that a large portion of Medicaid costs are financed by the Federal and State governments, the program cost $301 million in City funds in fiscal 1975.

Taken together, Medicaid and Public Assistance consumed 23 percent of the City's 1975 budget.

2. Traditional City Services

Although spending for traditional City services expanded at annual rates of approximately 9.6 percent between 1960 and 1970 in response to demand for higher quality services and the increasing salaries of city employees, the percentage of all City resources allocated to these areas declined due to the rapid growth in social services expenditures. Welfare and health shares of the budget increased from 23.4 percent to 33.4 percent from fiscal 1960 to fiscal 1975 while the shares of police, fire and environmental protection declined from 25.3 to 21.2 percent, from 9.6 to 6.9 percent, from 5.0 to 3.0 percent and from 5.1 to 3.0 percent, respectively.

Not only did total City expenditures show a substantial shift in the allocation of the City's resources over the past fifteen years, a similar redistribution occurred with respect to allocation of the City's locally raised tax levy revenues. Tax levy monies for these traditional services declined from 45.9 percent to 41.7 percent between fiscal 1960 and 1975.

3. Personal Service Costs

Over the 1960-1975 period, wage and salary costs increased 316 percent while the total budget increased more than fivefold. The share of personal service costs in the total budget decreased from 51 percent in 1960 to 35 percent
in 1975, largely because of the increasing cost of other than personal service costs such as public assistance, Medicaid and debt service.

Personal service cost increases are the product of increases both in the number of City employees and in their salary levels. From fiscal 1960 to 1975, the number of City employees grew from 256,000 to 322,000 positions, an increase of 30 percent. Wage and salary raises substantial enough to permit a decided rise in the standard of living were enjoyed by City employees during this period. As the table below shows, for certain positions, while the Consumer Price Index rose 80 percent between 1963 and 1975, representative salaries increased more rapidly, by 84 to 135 percent. (Data back to 1960 is not available on a comparable basis). Most employees were able to improve their purchasing power by 0.5 to 4.5 percent in real terms annually between 1963 and 1975.

CHANGES IN PERSONAL SERVICE
Number of Positions (1)

<table>
<thead>
<tr>
<th>Title</th>
<th>1963</th>
<th>1975</th>
<th>% Change</th>
<th>Av. Annual</th>
<th>% Change</th>
<th>Av. Annual</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sanitation Man</td>
<td>9,653</td>
<td>10,563</td>
<td>9.4</td>
<td>8,372</td>
<td>(20.7)</td>
<td></td>
</tr>
<tr>
<td>Patrolman</td>
<td>18,872</td>
<td>23,301</td>
<td>23.5</td>
<td>18,007</td>
<td>(22.7)</td>
<td></td>
</tr>
<tr>
<td>Teacher</td>
<td>42,386**</td>
<td>61,582</td>
<td>45.3</td>
<td>52,085</td>
<td>(15.4)</td>
<td></td>
</tr>
<tr>
<td>Senior Clerk</td>
<td>2,700</td>
<td>6,298</td>
<td>133.2</td>
<td>4,901</td>
<td>(22.2)</td>
<td></td>
</tr>
</tbody>
</table>

Representative Salary (2)
(Wage & Fringes excluding Pensions)

<table>
<thead>
<tr>
<th>Title</th>
<th>1963</th>
<th>1975</th>
<th>% Change</th>
<th>Av. Annual</th>
<th>% Change</th>
<th>Av. Annual</th>
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<tbody>
<tr>
<td>Sanitation Man</td>
<td>6,419</td>
<td>14,990</td>
<td>133.5</td>
<td>17,074</td>
<td>13.9</td>
<td></td>
</tr>
<tr>
<td>Patrolman</td>
<td>7,873</td>
<td>18,513</td>
<td>135.1</td>
<td>20,794</td>
<td>12.3</td>
<td></td>
</tr>
<tr>
<td>Teacher</td>
<td>7,623*</td>
<td>16,576</td>
<td>117.4</td>
<td>18,983</td>
<td>14.5</td>
<td></td>
</tr>
<tr>
<td>Senior Clerk</td>
<td>4,612</td>
<td>8,494</td>
<td>84.2</td>
<td>10,184</td>
<td>19.9</td>
<td></td>
</tr>
<tr>
<td>CPI (1963 Base as 100)</td>
<td>100</td>
<td>180.2</td>
<td>80.2</td>
<td>210.2</td>
<td>16.7</td>
<td></td>
</tr>
</tbody>
</table>

* As of December 31, 1961
**Authorized Positions Fiscal 1963

Notes:
1) Number of positions and salaries are as of 12/31 of that fiscal year; for teachers in 1975, as of 6/30/75.
2) Representative salary for:
   a. Teacher, Senior Clerk are average salaries.
   b. Sanitation Man and Patrolman are 1st Grade 10-year men.
3) CPI is the prior December reading taken from the New York-Northeastern, N.J. Consumer Price Index.
4) "Old" COLA and "Productivity" COLA are included in averages.
5) Overtime is not considered in any average.
4. **Pensions**

As salary costs increased, so did the cost of pension contributions. Expenditures by the City and certain covered organizations for retirement benefits increased 438 percent between fiscal 1961 and 1975, reflecting reductions in the employee portion of pension funding as well as increases in benefits established by State law. Pension costs as a percentage of total expenditures remained relatively stable at approximately 9 percent annually, partly because the expense budget for other items was increasing more rapidly and partly because required pension fund contributions did not reflect realistic assumptions of the eventual liabilities of the pension systems.

5. **Debt Service Costs**

The cost of City debt service more than quadrupled during the 1960-1975 period, increasing from $418 million in fiscal 1960 to $768 million in 1970 and to $1,896 million in 1975, as the City became increasingly reliant on the issuance of debt to fund its operations. Factors that increased the City's debt service costs included:

- rising interest rates in response to market conditions; the ever-increasing amount of City debt issuances;
- shortening of maturities in the City's overall debt structure; and
- increases in the amount of short-term borrowings.

The particularly acute $651 million increase in debt service costs from 1974 to 1975 was also attributable to the City's need to make budgetary provision for payment of $308 million in budget notes that had been issued to fund operating deficits in prior years.

C. **COMPOSITION OF THE CITY'S REVENUE SOURCES**

The nature of the revenues supporting the City's expense budget changed substantially during the 1960-1975 period. Of the fiscal 1960 budget of $1,995 million, $565 million or 23 percent was Federal and State aid, consisting mostly of State aid to education and general (per capita) State aid. In the 1960-1969 period, the absolute level of Federal and
State aid quintupled, from $419 million to $2,263 million, and further, though smaller, increases were registered in the 1969-1975 period. As a proportion of the budget, Federal and State aid payments rose from just one-fourth of the budget in 1960 to nearly 40 percent of the total in 1969, a level which has been maintained since that time. The following chart, drawn to a logarithmic scale, indicates the changing patterns of this growth.

* The 1975 peak, it is important to note, was significantly affected by a one-time event connected with the City's fiscal crisis of that year. In order to meet the City's financial commitments, the State of New York advanced nearly $800 million during the last three months of the City's fiscal year against aid payments that were due the City in the City's next fiscal year. Because of the three-month overlap between City and State fiscal years the advance did not represent an actual increase in aid from the State's viewpoint. However, to the City budget it did represent a real one-time increase.
Although the level of Federal and State aid in the budget grew dramatically, this did not reduce the demand for City funds. Not only was the bulk of Federal and State aid unavailable for general City services, but it was offered on the condition that it be matched by City funds in various mandated ratios.

As demands for City funds grew, the real property tax - the mainstay of local revenues accounting for over half of the receipts - was tapped more heavily. Construction in New York City had shown remarkable vitality in the post-World War II period, reaching its peak in 1964 when $1,346 million of new buildings was added to the tax base in a single year. But one by one the sources of new construction demand faded away as private home sites were used up, as apartment buildings erected with permits secured under the less restrictive zoning regulations were completed and as the rush of new office buildings caught up with or exceeded demand. Rising real estate taxes, difficult in a strong economy, became more burdensome when growth slackened. To respond to this increasing demand on real property tax revenues, sources of City funds were both expanded and refined in an attempt to create an overall package of non-property taxes that would be more equitable as well as more responsive to changes in economic activity. The City personal income tax was instituted in 1966. The stock transfer tax was shifted from the State to the City in 1965 and in 1966 there was a shift from taxes on business gross receipts to taxes on business income.

As indicated in the following chart, the gross revenues of the economically sensitive taxes have shown an average 12.7 percent growth over the 1969-1976 period. There were two sharp increases in revenues: in fiscal 1972 when there were increases in the rates or base in the general corporation tax, the unincorporated business tax, the financial tax and the personal income tax; and in 1976 when there were increases in all the taxes with the exception of the unincorporated business tax. Thus, when the revenues are adjusted for rate changes and additions to the taxable base, the average annual growth in the 1969-1976 period was 4.7 percent.
Growth In Economically Sensitive Tax Revenues*

<table>
<thead>
<tr>
<th>Year</th>
<th>Actual Revenues</th>
<th>Revenues That Would Have Been Received if Rates and Base Had Remained Unchanged</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979</td>
<td></td>
<td></td>
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<tr>
<td>1978</td>
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<tr>
<td>1970</td>
<td></td>
<td></td>
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<tr>
<td>1969</td>
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</tbody>
</table>

MILLIONS OF DOLLARS

SOURCE: ACTUAL REVENUES—CITY COMPTROLLER'S REPORTS
PROJECTIONS AND ADJUSTED REVENUES—OFFICE OF MANAGEMENT AND BUDGET

* Sales, Personal Income, General Corporation, and Unincorporated Business Taxes.

Of the $2.1 billion in economically sensitive taxes received in 1976, $1.14 billion represents the total increase in actual revenues since 1969. Of this, $850 million is due to tax rate and base changes and only $290 million is due to "true" revenue growth. As this ratio indicates, the declining trend in the City real wealth overwhelmed the City's efforts to increase tax revenues.
D. ACCOUNTING CHANGES

Pleas to the State to assist the City were partially met by additional aid, but more often, with the concurrence of the State Legislature, new fiscal devices, many questionable, were formulated to enable the City to balance its budget. The most well known technique was the financing of certain expense items from the capital budget.

The Capital Budget is intended to provide for the authorization and appropriation of funds for major physical construction or long-term capital projects. Under the State Local Finance Law, the City may issue serial bonds to fund these projects if they have a period of probable usefulness (PPU) greater than one year. For instance, the acquisition, construction or reconstruction of a water system can be bonded over a 50 year period; parks 10-20 years; and highways 5-15 years.

As the City developed the need for additional funds, the concept of a long-term development project was expanded at first to include general planning and repairs and maintenance and then to include "intangible development" or "creation of assets" of the City. Thus, manpower training and vocational education, which might provide a future skilled labor force, were viewed as programs designed to create new City "assets". As such, they were treated as items that would be bonded under the Local Finance Law, generating revenues for the expense budget. These changes in the Local Finance Law allowed the City to increase revenues from this source from $74 million in 1968 to $180 million in 1970 and $835 million by 1975.

Other changes in accounting techniques were introduced to recognize future expected State and Federal revenues in current years.

These accounting and financing changes, which started modestly in 1969, continued to grow, enabling the City to continue to increase budget expenditures despite the continuing decline in real personal income and GCP. These accounting techniques are one reason the City had accumulated a deficit in excess of $5.2 billion as measured by generally accepted accounting principles by fiscal 1975.
E. BORROWING TO FINANCE THE BUDGET

The bulk of Federal and State categorical aid that began in the 1960's came to the City in the form of "reimbursable" programs - programs that required the locality to obtain the aid by claiming reimbursement for expenditures already incurred. Upon submission of a claim by a locality, legitimate expenditures for eligible activities would be reimbursed by the Federal and State governments. The major programs operated in this fashion included welfare, social services and Medicaid.

Revenue anticipation notes (RANs) were issued to bridge the time between the City expenditure and the anticipated reimbursement but processing delays both by the City and the Federal government delayed the receipt of the revenue, causing note rollovers into the next fiscal year. In the next year the cycle would start again: new expenditures, new RANs and delayed receipt of revenue. The whole process served to obscure the crucial question of whether the City would ever receive revenues to reimburse it for its initial outlays.

Just as the City programs were building up to full operation, the Federal government started a major retrenchment to save Federal dollars by impounding funds and placed an after-the-fact expenditure ceiling on certain expenditures under Titles IV and XVI of the Social Security Act. As a result, the revenue in anticipation of which expenditures had already been made was never forthcoming.

Federal aid in the budget increased from $209 million in 1965 to $1,911 million in 1975. In 1965 the City issued no RANs at all against Federal aid but by 1971 there were $393 million of RANs outstanding against Federal aid at the end of the fiscal year and by the end of 1975 $800 million of such obligations were outstanding.

Even increases in State aid to the City caused the City to borrow. To meet its own budget needs, the State increasingly pushed off its aid payments to the first quarter of the State's next fiscal year - the last quarter of the City's. Until funds started coming in, the City was forced to borrow by issuing RANs. Thus, as State aid in the budget increased from $544 million in 1965 to $2,044 million in 1975, so did the amount of RANs issued against it. The amount of RANs outstanding against State aid at the end of the fiscal year increased from $62 million in fiscal 1965 to $572 million in 1971 and to $1,760 million in 1975.
Another means of bridging the gap between the timing of City expenditures and the receipt of cash was the issuance of notes in anticipation of receipt of real estate tax payments. As the total tax levy increased from $1.9 billion in 1970 to $2.9 billion in 1975 in response to a 33 percent increase in the tax rate and a 15 percent increase in assessed value, the amount of notes that could be issued increased accordingly.

The rapid rise in the tax strained the ability of taxpayers to meet their obligations; at the same time increasing levels of tax abatements were being granted for housing and other purposes without adjustment of tax collection estimates. As a result, increasing amounts of tax were left uncollected at the end of the fiscal year in which they were due. Notes issued in anticipation of the uncollected taxes were rolled over at the end of the fiscal year and the cycle of borrowing was resumed the next fiscal year. By 1975, the amount of tax anticipation notes (TANs) outstanding on June 30 was $380 million, more than double the $170 million outstanding at the end of fiscal 1970.

As part of the City's overall expansion in the kinds and quality of services delivered to its residents that began in the late 1960's, the capital program was also expanded. This expansion was further increased by including expense items in the capital budget as a way to enlarge the revenues available to the expense budget. City funds appropriated in the Capital Budget increased to an average of $1,248 million in the 1971-1975 period, compared to $644 million for the preceding five year period. Cash outlays increased accordingly, from $550 million annually in 1966-1970 to $1,354 million annually in 1971-1975. Since these capital outlays were to be financed by borrowing, the issuance of funded debt also increased.

Additional requirements for the issuance of long-term debt arose from the City's Mitchell-Lama program of mortgage loans to housing companies for construction of new housing. The program had been initiated in the 1950's to take advantage of the City's ability to borrow inexpensively on a tax exempt basis and therefore lend less expensively than traditional sources of mortgage money.

To fund the program, the City issued bond anticipation notes (BANs) while the projects were in construction and redeemed the notes from time to time by issuance of bonds. In 1965, the City's interest rate on 50-year debt issued for the program was 3.7 percent; by the end of 1970, the City's
interest rate on 30-year debt issued for general purposes exceeded 7 percent — the result of a general increase in interest rates as well as the City's deteriorating credit standing. Hoping that long-term rates would come down, the City stopped issuing bonds for Mitchell-Lama purposes during this period, choosing instead to rollover its BANs and to issue additional BANs to finance further mortgage advances to housing projects. At the same time, the number of projects undertaken and their per unit costs were also on the rise. As a result, the amount of new BANs issued and never redeemed by issuance of bonds averaged $64 million annually in fiscal 1965-1970 and $144 million in 1971-1975 so that by June 30, 1975 the City had outstanding $1.1 billion in BANs issued for Mitchell-Lama purposes and another $118 million of BANs issued for municipal loans to owners of multiple dwellings. Further, an additional $200 million in debt issuance remained to complete the financing of projects already in construction.

As the capital program expanded and expense items in the Capital Budget recurred year after year, room within the City's constitutional debt limits for new obligations became very limited. To circumvent these limitations, the City, following the State's precedent of setting up "moral obligation" public authorities to do construction and the borrowing necessary to fund it, set up its own public authorities such as the New York City Housing Development Corporation and the Educational Construction Fund and entered into lease agreements with State authorities that would enable construction of public facilities, thereby adding another burden on the credit market.

Although each one of these factors would have been reason for concern, their convergence was devastating. As the following table shows, by the end of fiscal 1975 the amount of short-term debt outstanding was $4,540 million — 52 times as great as it had been only 15 years earlier.

DEBT OUTSTANDING AT FISCAL YEAR-END
($ in Millions)

<table>
<thead>
<tr>
<th></th>
<th>TANs</th>
<th>BANs</th>
<th>RANs</th>
<th>Other</th>
<th>Total Short-Term</th>
<th>Funded Debt</th>
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<tbody>
<tr>
<td>1960</td>
<td>41.9</td>
<td>33.3</td>
<td>-</td>
<td>13.2</td>
<td>88.4</td>
<td>4,208.6</td>
</tr>
<tr>
<td>1965</td>
<td>88.8</td>
<td>225.3</td>
<td>118.6</td>
<td>92.8</td>
<td>525.5</td>
<td>4,704.5</td>
</tr>
<tr>
<td>1970</td>
<td>170.0</td>
<td>467.6</td>
<td>536.7</td>
<td>113.9</td>
<td>1,288.2</td>
<td>5,235.8</td>
</tr>
<tr>
<td>1975</td>
<td>386.0</td>
<td>1,570.2</td>
<td>2,560.0</td>
<td>30.0</td>
<td>4,540.2</td>
<td>7,766.5</td>
</tr>
</tbody>
</table>
III. THE CRISIS

These, then, were the forces impacting the City in fiscal 1975 -- the accumulated budget deficit of over $5 billion, faulty accounting practices, an eroding tax base and mounting municipal services, adverse national trends, discriminatory Federal policy. And they were largely underwritten by increasing the City's short-term debt from $0.5 billion to $4.5 billion in the decade preceding the fiscal crisis, thereby truly mortgaging New York's future.

The reckoning came in the spring of 1975 when the City's underwriters informed the Mayor and the Comptroller that New York securities could not be sold publicly. At that time, the credit markets were in disarray as a result of restrictive monetary policies undertaken by the Federal Reserve Board to control an inflation rate exceeding ten percent on an annual basis. The nation was also in the midst of a recession that led to the highest unemployment rates since the Depression. Caught between inflation and recession, the public credit markets refused to absorb the indebtedness of a City whose budget deficit was mounting and whose accounting practices were suspect.

The reaction to the City's exclusion from the credit markets was immediate and multi-faceted, including both fiscal and financing actions and involving the State and the Federal governments as well as the City.

First, to enable the City to meet its short-term needs, the State advanced the City $800 million in aid that it was scheduled to receive in the next fiscal year. This advance, repaid by withholding state aid, has been continued in each subsequent year and constitutes a working capital shortage resulting from past budget deficits.

However, the City's short-term needs proved to be greater than the $800 million provided by the State Advance so the Municipal Assistance Corporation ("MAC") was established in June 1975 to serve as the City financing agent. MAC's principal function was to convert the City's short-term debt into long-term obligations. Because MAC was a State agency backed by the State's moral obligation and because the City's sales and stock transfer taxes were pledged to meet MAC's debt service costs, it was believed that the Corporation could issue bonds when the City could not.

Unfortunately, the market failed to distinguish MAC from the City in determining the Corporation's credit standing. As a result, MAC had also been excluded from the market by the beginning of September.
To correct one of the basic impediments to market access -- the inability of the City to balance its budget -- on September 9, 1975 the State passed the Emergency Financial Act that required the City to prepare a three-year plan designed to balance its fiscal 1978 budget in accordance with prescribed accounting principles. This Act also established the Emergency Financial Control Board ("Control Board") to insure that the City adhered to the requirement of a balanced budget, as prescribed, by fiscal 1978.

Accordingly, the City prepared a financial plan of projected revenues and expenses for fiscal years 1976, 1977 and 1978 based on revenue estimates approved by the Control Board. This financial plan, as modified by the Control Board, was approved on October 20, 1975.

With the passage of the Financial Emergency Act, the State initiated a financing program to meet the City's short-term needs for the next three months. Basic to this program was a $750 million investment by the State in City securities. It was matched by financing commitments from New York City banks, City pension and sinking funds, other City-based financial institutions and the State Insurance Fund.

At the time this financing package was designed however, it was recognized that it was only an interim measure and work was immediately started on a more comprehensive proposal. This plan was announced in November and it contained four main elements:

- **Moratorium:** On November 15, 1975 the State Legislature adopted the Emergency Moratorium Act that permitted the City to suspend payment of principal on its short-term debt for a three-year period.

- **Taxation:** On November 26, 1975 the State Legislature enacted tax increases for the City, calculated to provide $500 million in increased revenues over the next three years.

- **Exchange Offer:** On November 26, 1975 the Municipal Assistance Corporation offered, as a part of the Emergency Moratorium Act, to exchange its eight percent bonds for approximately $1.6 billion of City notes then held by the public; $458,275,600 of notes were exchanged for an equal face amount of MAC bonds.

- **Amended and Restated Agreement:** On November 26, 1975, an agreement was also reached with the New York Clearing House Banks and with the City pension and sinking funds, providing that the sinking funds would exchange $200 million of City notes held by them for long-term City bonds, the banks and the pension funds would
restructure their previously purchased $1,808,323,000 of MAC bonds by reducing interest rates and altering maturity schedules, and the pension funds would invest $2.5 billion in new long-term City bonds over the next three years.

One of the purposes of the November 1975 actions was to secure Federal financing assistance. This was achieved on December 15 of that year when the President of the United States signed into law the Seasonal Financing Act. This act was designed to meet the City's short-term borrowing needs arising from differences in timing between expenses and revenues.

To effect the Seasonal Financing Act, the City, the State, the Control Board and the United States entered into the Federal Credit Agreement, dated December 30, 1975. Under this agreement, the Secretary of the Treasury was authorized to make short-term loans of up to $1.3 billion in fiscal 1976 and up to $2.3 billion in fiscal 1977 and 1978.

In fiscal 1976, the City borrowed $1.26 billion under this agreement, with repayment being made in full on June 30 of that year. In fiscal 1977, the City borrowed $2.05 billion that was repaid in full by June 30, 1977, with certain repayments being made in advance of maturity. During the current fiscal year, the City has borrowed $1.875 billion to date and it does not expect to make any additional borrowings under the agreement.

As the Secretary of the Treasury stated in his testimony before the House Subcommittee on Economic Stabilization, the City of New York has met all the important requirements of the Seasonal Financing Act, with each repayment being made on time or in advance. In addition, the Federal government has earned over $30 million in profit from the loans made to the City since they carry an interest rate one percent above the Treasury's borrowing rate.

The State Moratorium Act did not however fare as well as the Federal Seasonal Financing Act for it was declared unconstitutional by the State Court of Appeals in November 1976, with a remittitur providing for payment of the notes being issued the following February. Of the $1.8 billion of City notes that were outstanding at the time the Moratorium Act was declared unconstitutional, about $400 million were exchanged for MAC bonds in March 1977, approximately $415 million was repaid with City funds by the end of October 1977, and $819 million held by the pension funds and the Clearing House banks was exchanged for MAC bonds. In November 1977, the City defeased the moratorium notes by setting aside a total
of $167 million for the payment of current and anticipated claims by holders of these notes. Thus, through the issuance of MAC bonds, by exchange of City notes for MAC bonds and with its own funds, the City provided for the redemption or the refinancing of all the $4.5 billion of City notes that were outstanding on June 30, 1975.

The above-mentioned exchanges of $819 million of City notes for MAC bonds in October 1977 by the banks and pension funds was part of an amendment to the Amended and Restated Agreement known as the Restructuring Agreement. Under this agreement, the banks and the pension funds also agreed to exchange approximately $1.55 billion of outstanding MAC bonds for new MAC bonds with longer maturities and higher interest rates and the pension funds agreed to purchase $736 million of City bonds during fiscal 1978, including reinvestment of $236 million of maturing City bonds.

In November 1977, as a condition of the Federal Financing Act that the City make its best efforts to meet its short-term borrowing needs in the public credit markets, the City attempted to sell $200 million of notes through an underwriting syndicate. Assigned an MIG-4 rating by Moody's Investors Services, these securities did not meet the quality requirements of investors and the City's underwriters recommended that the offering be cancelled.

The reason given for the failure of the November note offering was that investors still lacked confidence in the City's ability to meet its financial obligations. This lack of confidence stemmed from two sources:

- the imbalance in the City's budget in terms of generally accepted accounting principles, although for fiscal 1978 the City expects to balance its budget in accordance with the Financial Emergency Act; and

- past financing pressures, in spite of funding the $4.5 billion in short-term debt that was outstanding on June 30, 1975.

The past financing pressures facing the City are carry-overs from the 1975 crisis and include:

- operating expenses in the City's fiscal 1978 capital budget; these items are a holdover of past fiscal abuses and my Administration is committed to phasing them out twice as fast as required by law;
- the $800 million State Advance which, like all working capital shortages, should be permanently funded;

- MAC capital reserve requirements which, as a protection to investors, must equal one year of MAC's debt service requirements by the end of fiscal 1979; and

- MAC refinancings to restructure the Corporation's debt as to rate and maturity.

The principal areas where the City has not had GAAP-based accounting in recent years is in the inclusion of certain operating expenses in the capital budget and in the understatement of pension costs. In the Financial Emergency Act of 1975, provision was made to phase these expense items out of the capital budget over ten years. In the same year, the Pension Task Force of the Mayor's Management Advisory Board was established to recommend the funding patterns the City should follow to make the pensions sound actuarily. These proposals were adopted in 1977 and the City expects to bring its provision for pensions in line with generally accepted accounting principles by fiscal 1982.

In addition to these steps, the City has taken the following actions to balance its budget:

- Work Force Reduction: the City's work force has been reduced by 61,000 employees since December 31, 1974; this represents almost a 21% reduction over the work force on December 31, 1974.

- Debt Service Reductions: debt service has been reduced from $2309 million in fiscal 1976 to an estimated $2010 million in fiscal 1978, primarily through restructuring.

- Increased Real Estate Tax Collection: improved procedures have resulted in reductions of uncollected real estate taxes ($12 million) and a substantial increase in the collection of prior year's taxes ($52 million more in fiscal 1977 than in fiscal 1976).

- State Takeover of the Courts: the enactment of legislation providing for the takeover of the courts system by April 1, 1980 will generate savings of approximately $16 million, based on revised estimates in fiscal 1978; an additional $25 million will be saved in 1979.
- State Support of CUNY: the assumption by the State of a greater share (75%) in the support of CUNY senior colleges has reduced the City's share by $54 million in fiscal 1978; in addition, the implementation of tuition reduced the need for State/City support by $85 million in 1977.

- Federal Acquisition of Public Housing: in fiscal 1978, the federal government acquired approximately 15,000 units of state owned public housing, reducing the subsidy required from the City by approximately $8 million in 1978 and $11 million in 1979.

- Reduction in Pension Contributions: since 1976 City workers have been required to contribute between 2% and 2.4% more to the costs of their pensions; due to the two year lag, this action will save the City approximately $49 million in fiscal 1978, with the savings to increase to $95 million in 1979.

- Mitchell-Lama Refinancing: as of January 15, 1978, $120 million net cash has been realized through the refinancing of projects through the Federal Housing Administration (FHA); pursuant to Section 233 (f) (Public Law 93-383), an additional $160 million is expected to be raised in fiscal 1978.

- Public Assistance Cost Control Program: implementation of programs to reduce acceptances of ineligible clients, to detect fraud, to eliminate special payments and to improve management will produce a savings of $266 million for fiscal 1977 and 1978; as a result of these programs, welfare rolls have been reduced to the lowest level since 1970.

- Transit Fare Increase: in September 1975 the NYC Transit Authority increased New York City transit fares for subways and busses over forty percent from 35¢ to 50¢; this action produced an increase in revenue of approximately $150 million.

- Closing of Fire Companies: 19 fire companies have been closed.

- Elimination of Funding for Day Care Centers: the funding of 77 day care centers has been transferred to other parties or eliminated.
- Electricity Savings: energy conservation programs and the purchase of electricity from the Power Authority of the State of New York, instead of Consolidated Edison, reduced electricity costs by $25 million for fiscal 1978 below estimated costs.

- Tax Increases: since 1975 the City has raised taxes on personal income, on several types of business income, on stock transfers, and on cigarettes while extending the sales tax; in an effort to enlarge the economic base of the City, a detailed Economic Recovery Plan allowing for some tax reductions was begun in fiscal 1978; although the increases in taxes since 1975 yield approximately $445 million annually to the City, the fiscal impact on the Economic Recovery Plan cannot be quantified at this early date but it is expected that the annual revenue loss of approximately $200 million will be offset by economic growth directly stimulated by the Recovery Plan.

- Establishment of the Integrated Financial Management System: IFMS has allowed the City to better control expenditures and collect receivables.

This program of fiscal stringency is a primary reason the City was able to repay all its seasonal borrowings by year-end in fiscal 1976 and 1977 and it is the principal reason the City expects to have repaid all such indebtedness by the end of the current fiscal year. This record of repayment has prompted the Citizens Budget Commission, an independent fiscal watchdog group based in New York, to say "one of the proudest achievements over the past three years is the City's record in settling each year all seasonal borrowings on time prior to the beginning of the succeeding fiscal year."
IV. FOUR YEAR FINANCIAL PLAN

Prior to my taking Office, the Secretary of the Treasury asked me to prepare a plan that would serve as a blueprint for the City's effort to attain fiscal stability. My Administration had been in office less than three weeks when a Four Year Financial Plan was submitted to the Secretary on January 20. The centerpiece of this Plan is a Federal guarantee of securities to be sold to City and State pension funds to finance the City's true capital needs. We also have proposed extension of seasonal financing assistance, on a reduced basis. As we set forth in the Four Year Plan, the total Federal credit exposure would never be as great as the $2.3 billion short-term line of credit currently available to the City under the Seasonal Financing Act of 1975.

A. LACK OF MARKET ACCESS

When the Seasonal Financing Act was passed, City and State officials, as well as the Congress, believed that the City's Financial Plan would enable it to balance its budget in accordance with the Municipal Assistance Corporation Act by 1978. The financing arrangements undertaken at that time were intended to provide a financing bridge over the three year period so that the City could regain access to the public credit market during its 1978 fiscal year. Although the City expects such a balanced budget this year, the market problems were more severe than anyone realized and the City has not been able to sell its securities publicly.

As you know, investor confidence is a fragile commodity. It cannot easily be won but it can be lost quickly. And once it is lost, it is very difficult to regain. Above all, it is the lifeblood of the securities market.

Investor confidence in the City of New York was shattered in the 1975 fiscal crisis. That it has not been regained was demonstrated in the failure of the City's note offering in November.

Yet, in spite of that failure, you have concluded that the City does not need a guarantee, saying that local sources of funds are adequate to meet the City's financial needs. Identifying sources of funds, unfortunately, is not the same thing as getting the funds. While local institutions obviously have the ability to meet the City's financing needs, the ability to lend and the willingness to lend are not synonymous. The failure of the November offering points up the difference. It reflects the lack of investor confidence in the City of New York.
This lack of confidence is further reflected by the public statements of persons responsible for investing the sources of funds identified in the Four Year Financial Plan. The State Comptroller, citing his fiduciary responsibilities, has refused to invest substantial amounts in City securities. The consultant on pensions to several municipal unions stated in hearings conducted by the House Subcommittee on Economic Stabilization that he would not invest in additional City securities without a Federal guarantee. Mr. Elmore Patterson, chairman of the Executive Committee of Morgan Guaranty Trust Company of New York, said "if there is no federal assistance after June 30, I do not feel very hopeful about raising any additional money from these local sources which act in the capacity of depository or fiduciary for the people's money." Mr. John A. Raber, President of the Savings Bank Association of New York State, also spoke of fiduciary responsibilities in his testimony before the Subcommittee.

In addition to the above statements, the City has been informed by MAC that the City could not expect to enter the public credit markets in the near future. Thus, the advice we receive from bankers and financial advisors is nearly unanimous -- the City does not have access to the marketplace.

We designed the Four Year Financial Plan to make the City creditworthy. The Plan presents a comprehensive approach by which the City can achieve a truly balanced budget by fiscal year 1982. But restoring the City's access to the public credit markets will require firm long-term and short-term financing commitments to sustain the City during the four-year period ahead.

**B. FEDERAL-STATE-CITY PARTNERSHIP**

Basic to the plan is the concept of a City-State-Federal partnership. It calls on all levels of government to continue, and to increase, their efforts to solve the City's long-term problems.

The State of New York has been asked to help because under our Federal system, states have primary responsibility for cities within their jurisdiction. The Federal Government has been asked to help because many of the problems confronting the City are national problems. For example, the City's share of welfare and medicaid payments -- $1.2 billion -- is greater than its budget gap in accordance with generally accepted accounting principles.

I am happy to report that the Governor and the State legislative leaders have agreed on the State's share of this effort. An additional $250 million in aid for the City was included in the State's fiscal 1979 budget.
We also have held discussions with the Administration regarding the Federal share of the increased aid package -- in particular, we will be pressing for a continuation of the New York City countercyclical revenue sharing program as the principal source of increased Federal assistance in 1979. However, over the long term, we believe that a fundamental change in the Federal and State share of welfare and Medicaid assistance will be necessary for the City to eliminate its budget gap.

I also want to make it clear that the Four Year Plan does not ask others to do what the City should do for itself. As I have said, the Plan is based on the idea of partnership. And during this four-year period, actions taken by the City will account for 50 percent of the total gap to be closed.

It is of course one thing to talk about taking such actions and quite another to effect them. I however want you to know that my Administration is intent upon implementing its part of the City-State-Federal partnership. In the Executive Budget submitted to the City Council on April 26, we reflected the budget targets set in the Four Year Plan by taking the following actions:

- A further reduction in the municipal work force through attrition;

- A cost control program in materials and supplies that will force a decline in real purchases of 12 percent during the next four years;

- Changes in health service delivery and continuation of the City's successful cost containment program in the areas of public assistance and social services;

- Management improvements based on audits developed by the City Comptroller; and

- The reduction of capitalized expenses by $193 million.

C. MANAGEMENT IMPROVEMENTS

In addition to these steps, I have taken a number of actions to improve the performance of the City's agencies. One of the first acts of my administration was to appoint a Deputy Mayor for Management who was assigned to ensure that the highest priorities be given to major problems of program coordination. In addition, I have upgraded and expanded the Office of Operations -- my team of management analysts and
innovators. Currently, they are examining the organization of all the City's agencies to determine those areas in which excess personnel might be reduced as well as the best organizational structure for each agency.

A second major emphasis has been on the removal from the work force of employees who do not perform. Each of my commissioners knows that "no-shows" and incompetents are not welcome in my administration. Each commissioner is making use of the available procedures to eliminate these workers from the City's payroll. On a Citywide basis, disciplinary action has been taken against 1507 municipal employees; 55 of these charges resulted in terminations in the first few months of my administration. This is, of course, not an attempt to purge the work force for arbitrary reasons. Rather, it is an effort to facilitate a more efficient operation and to provide necessary services to the citizens of New York City.

Shortly after taking office, I authorized the implementation of the City's new management service plan, which will provide greater flexibility and management control within City agencies. It includes a broad-banding of managerial civil service titles, reducing the number of titles significantly and allowing a more efficient deployment of managers based on their expertise and abilities. The plan also provides flexibility in the compensation of managers so that we can reward those who excel without rewarding those whose performance is not up to our high standards. Also included in this management package is our proposal, now before the state legislature, to remove 3,000 high level managers from collective bargaining. If approved, this will remedy the intolerable condition whereby less than a dozen of the top people are not part of the bargaining system in some departments.

I am also committed to the idea that we must improve the efficiency with which our many federally funded programs are operated. All of my commissioners are on notice that they must apply the highest possible standards in terms of performance and honesty in the conduct of their programs. In our CETA program, for example, my administration has required that all of the contracts that it inherited be placed on a 90-day status to allow for a thorough review of the contracting organizations. For all our federally funded contracts we have established a system of careful review before the contract is officially acted on by our Board of Estimate. As a result, we now have better documentation on the reliability and performance of City contractors than we have ever had before.
In addition to these measures, the City has undertaken a number of reorganizations that will improve the performance of City agencies. The first initiative is the restructuring of the Office of Economic Development. The Mayor has recently appointed a Deputy Mayor for Economic Policy and Development who will be in charge of the restructuring process. A major thrust of this process will be the integration of those units of City government that are directly involved in development, including: the Department of Employment, the Department of Ports and Terminals, the Office of Development and the Business Marketing Corporation. It is expected that a clearer allocation of functions among these units will result in a less costly but more effective economic development effort. The new Deputy Mayor will also take a leading role with respect to tax, energy and government regulatory policies and will chair a new Development Funds Steering Group that will coordinate the application for and use of federal dollars for economic development. The recently announced decisions to proceed with the construction of Battery Park City, Westway and a new Convention Center will bolster these efforts.

D. CAPITAL IMPROVEMENTS

These actions, and others to be taken in the future, will, I hope, convince you that we intend to improve the fiscal management of the City so that budget gaps do not reoccur. But balancing the budget is only part of the Four Year Plan. The City must begin to rehabilitate itself to help preserve the tax base because the tax base is the fuel that powers the urban machine. Unless we repair our streets and fix our water mains, improve our drainage system and rebuild our subways, New York City cannot provide the quality of life essential to maintaining such a balance.

To renovate the City's physical plant, I once again have relied on the concept of intergovernmental cooperation. We are asking the Federal Government to guarantee, with State participation, bonds to be sold for true capital improvements.

The amount of such outlays over the next four years total $2.3 billion. This is the level of capital expenditures that the City's engineers estimate is necessary to rebuild the physical plant and to construct essential projects. Unless these expenditures are made quickly, it may be too late to save what we already have.
In that case, the future cost to rebuild what was not or cannot be repaired will be prohibitive.

To halt the deterioration of the physical plant, the Four Year Plan calls for the following rehabilitation program:

- Instituting a 35-year replacement cycle for streets, a 40-year cycle for bridge roadways, a 100-year cycle for City sewers and a 75-year cycle for water mains instead of at current levels of expenditures whereby the City's physical plant is rebuilt every other century;

- Doubling the investment for transit modernization;

- Replacing aging Police, Fire and Sanitation facilities;

- Renovating piers and markets; and

- Supplementing the two fifty-year-old existing water tunnels with a third tunnel.

The Four Year Plan also calls for capital spending to build water pollution control plants in Brooklyn and Manhattan. These outlays, it should be noted, are required to match State and Federal funds.

In addition to $2.3 billion for true capital projects, the City will need nearly an equal amount over the next four years to relieve past financing pressures. This will include:

- $900 million to finance operating expenses in the capital budget;

- $500 million to bond the State Advance;

- $560 million to restructure MAC's debt by refunding MAC bonds; and

- $250 million to meet MAC's capital reserve requirements to provide additional security for investors.

Thus, the City's long-term financing needs over the next four years total $4.5 billion - $2.3 billion for capital improvements and $2.2 billion to relieve past financing pressures.
E. SOURCES OF CAPITAL

To meet these needs, the following sources of capital are suggested in the Four Year Plan:

($ in Billions)

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount</th>
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</thead>
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<td>City and State Pension Funds</td>
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</tbody>
</table>

As previously noted, the Plan contemplates that the pension fund purchases of bonds sold to finance true capital expenditures will be guaranteed by the Federal Government.

However, it is not merely the pension fund purchases that will be affected if the Federal guarantee is not extended. The entire plan will be jeopardized. It will be jeopardized because all the parts are dependent on each other. Unless the budget gap is closed and a balance maintained, investors will not have confidence in the City's ability to meet its financial obligations. Unless the physical plant is renovated, a long-term budget balance cannot be maintained. Unless a Federal guarantee is extended as part of a financing package, fiduciaries will be unwilling to risk the money that belongs to others.

Thus, the guarantee is included in the Four Year Plan to increase investors' willingness to lend to the City. Once it is in place, the City can move to meet the balance of its long-term financing needs.

The same is true with the City's short-term financing needs. Although the City Council has passed legislation to accelerate the payment of real estate taxes, our short-term needs could be as high as $1.5 billion in 1979. They arise from the timing differences between collections and expenditures -- the City's expenditures are relatively equal each month while a disproportionate share of its revenues come in the fourth quarter. To obtain the funds that the City needs to meet its operating expenses, the City must turn to outside sources. There again, a high level of confidence will be the necessary factor in determining
whether lenders are willing to extend credit. If we have Federal financing assistance, I feel certain that such credit will be forthcoming, at least in the amounts indicated in the Four Year Plan. Without assistance, our ability to secure credit is highly doubtful.

Of course, no one can predict the future with certainty. It is my belief however that a continuation of the seasonal financing program combined with a long-term guarantee will give the City time to achieve a record of balanced budgets while reducing past financial pressures so that it can enter the market on its own strength within the next four years.
V. LEGISLATION

A. CARTER ADMINISTRATION'S PROPOSAL

As you know the Secretary of the Treasury, W. Michael Blumenthal, has submitted the Administration's proposal for the City of New York. Under this proposal, the Federal Government would replace the Seasonal Financing Act with a program to guarantee up to $2 billion in long-term City or MAC securities. The guarantee would last for up to 15 years and the City would pay a guarantee fee of 0.5 percent on any guaranteed security.

The guarantee would be issued only if the City met the following conditions:

- Submission of a four year plan that by fiscal 1982 will produce a balanced budget in accordance with generally accepted accounting principles; and

- Creation of a fiscal monitor to review the City's finances, with the monitor's power to be at least as extensive as those of the Emergency Financial Control Board.

The security for the guarantee would be primarily Federal transfer payments to the City and secondarily Federal transfer payments to the State.

For having submitted this legislation, I want to thank the President of the United States, the Secretary of the Treasury and New York's two Senators, Patrick Moynihan and Jacob Javits. This marks a real beginning toward solving New York's financial crisis once and for all. By guaranteeing bonds that the City sells for true capital purposes, the Federal government will enable the City to undertake the renovation of the physical plant that is vital to its long-run health.

In regard to most of the Administration's proposal, I am in accord with Secretary Blumenthal. Prior to assuming office, I called for a continuation of the fiscal monitor. Legislation to continue the Emergency Financial Control Board has been submitted to the State legislature and that body is currently reviewing my proposal.

However, I urge the Committee to provide the City with a seasonal financing facility. As you know, the chief route to insolvency for the City in the short run is the inability to pay its bills due to a lack of credit. While I do not
intend to let the City slip into default, I believe that financial prudence demands that the City be assured of short-term funds by the Federal Government. We will do everything in our power -- accelerate the collection of real estate taxes, request an acceleration of State aid, attempt to sell notes publicly, try to arrange a line of credit -- to meet our seasonal needs. A continuation of seasonal financing assistance however would insure that the City could pay all its bills in the event that we are not successful in arranging for our short-term requirements in the public credit markets.

B. **MOORHEAD BILL (H.R. 12426)**

I want to thank Representative Moorhead of Pennsylvania for having introduced legislation to provide a Federal guarantee of City securities. I would also like to express the City's appreciation to Congressman Stewart McKinney of Connecticut and to Congressman Henry Reuss, Chairman of the House Banking Committee, for their help in securing Committee approval of this legislation. In some ways -- particularly in its extension of short-term financing assistance -- the Moorhead bill is an improvement over the Administration's proposal. However, in other ways, such as Federal transfer payment to the State as well as payments to the City being the primary security for the guarantee, the exclusion of interest from determination of the amount to be guaranteed and the right to waive the Federal priority in the event the guarantee must be utilized, the Administration's bill is superior. I urge this Committee to report out a combination of the two proposals that will insure that the City of New York never has to return to the Congress, its hat in hand, to ask for Federal financing assistance.
VI. LABOR NEGOTIATIONS

Initially, the City had hoped to settle its labor negotiations before approaching the Congress for legislation. This proved impossible. At this time, the City of New York is awaiting the ratification of the transit pact and negotiations with municipal unions are continuing.

The City cannot effectively negotiate under time constraints imposed by a demand to finalize a labor settlement with all City workers before enacting the Federal loan guarantee program. The fate of 7.5 million New Yorkers must not be jeopardized by the demands of 190,000 City workers. What is important is that the City conform to the objectives outlined in the Four Year Plan, so that any labor agreements do not result in an unbalanced budget.

It should be noted that with the continuation of the independent fiscal monitor - a requirement of both the House and Senate bills - the City cannot enter into labor contracts that would unbalance our budget or that are beyond the ability of the City to pay under the Four Year Financial Plan. In addition, the Federal legislation could contain the condition that no guarantees would be provided unless the Secretary of the Treasury certifies that the Financial Plan, which is on file with the Secretary, has not been breached.

On April 26, I submitted the Fiscal Year 1979 Executive Budget, which is balanced in accordance with the MAC Act. This budget provides funds for a reasonable settlement with the municipal labor unions. As you know, the Four Year Financial Plan made no provision for a labor settlement. The 1979 Budget, by making provisions for a labor agreement, eliminates this uncertainty.

Our offer to the coalition of municipal employees amounts to less than $700 million over two years, including $80 million in "give-backs" of previously negotiated benefits. In the context of our $13.5 billion budget, I believe that this increase, which is over two years, would be a very reasonable settlement. I realize that a reasonable labor settlement is critical to the availability of Federal assistance. Yet, delay in action on the legislation is undercutting my ability to negotiate such a settlement.
VII. CONCLUSION

Since the fiscal crisis began in 1975, the City has taken many steps to insure that all its expenses fall within its means. These steps to our continuing fiscal recovery often were painful; they were made through the cooperation and sacrifice of virtually every sector of our City's life. In many cases, these accomplishments were gained at the expense of customary municipal services, employment benefits -- and employment itself -- and urban amenities previously taken for granted. Yet the City of New York, determined to set its house in order, has taken these steps and will continue to take those steps necessary to carry forward our fiscal recovery.

In closing, I would like to make three observations and a promise.

Firstly, I cannot say with certainty that the City faces imminent bankruptcy if Federal financing assistance is not available. Obviously, however, the possibility exists. To me the consequences -- for the City, the State, the Federal government, the public credit markets and the foreign exchange markets -- are so great that I cannot conceive that responsible government leaders would even consider taking that risk.

Secondly, I want to say that I agree with the Secretary of the Treasury that over the long run the cost to the Federal Government of not helping the City will be greater than the cost of helping. If the City does not rehabilitate itself, it will decay and slowly die, becoming a ward of the State and the Federal governments. In these circumstances, denying the City's request for financing assistance today will prove costly tomorrow. It is being penny-wise, pound-foolish on an incredible scale. On the other hand, a Federal guarantee can be as financially rewarding for the Federal government as the seasonal loan program has been because we have offered to pay a guarantee fee -- an insurance premium if you like -- on the principal amount guaranteed. This Committee, like the Secretary of the Treasury, has already noted New York's creditworthiness in reporting that "The City has an impeccable record of repaying its seasonal loans (and) has made tremendous strides toward putting its financial house in order in the past three years." This, I submit, is a strong argument why the cost of the guarantee program to the Federal government will be small
Testimony by Mayor Edward I. Koch
City of New York
Before the Committee on Banking, Housing and Urban Affairs
Subcommittee on Economic Stabilization
The U.S. House of Representatives

Tuesday, March 7, 1978
Mr. Chairman and honorable members of the House Economic Stabilization Subcommittee:

Thank you for this opportunity to meet with this subcommittee of the House Banking, Finance and Urban Affairs Committee. It is always a pleasure to return to Washington and to see my former colleagues.

Today I appear before you as the Mayor of the City of New York, the elected representative of the seven-and-one-half million residents of the nation's largest City. I wish to present, in candor and frankness, my views of the City's financial needs, as well as its plans to balance its budget and regain access to credit markets. This plan, as you know, was presented to the Secretary of the Treasury, at his request, on January 20, 1978.

I. FOUR YEAR FINANCIAL PLAN

The linchpin of the Plan is a Federal guarantee of securities to be sold to City and State pension funds to finance the City's true capital needs. We also have proposed extension of the Seasonal Financing Act, on a reduced basis. As we set forth in the Four Year Plan, the total Federal credit exposure would never be as great as the $2.3 billion short-term line of credit currently available to the City under the Seasonal Financing Act of 1975.

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When the Act was passed, City and State officials, and the Congress believed that the City's Financial Plan would enable it to balance its budget in accordance with the Municipal Assistance Corporation ("MAC") Act by 1978. The financing arrangements undertaken at that time were intended to provide a financing bridge over the three year period so that the City could regain access to the public credit market during its 1978 fiscal year. Although the City expects such a balanced budget this year, the market problems were more severe than anyone realized and the City has not been able to sell its securities publicly.

As you know, investor confidence is a fragile commodity. It cannot easily be won but it can be lost quickly. And once it is lost, it is very difficult to regain. Above all, it is the lifeblood of the securities market.

Investor confidence in the City of New York was shattered in the 1975 fiscal crisis. That it has not been regained also was demonstrated in the failure of the note offering in November.

Yet, in spite of that failure, certain observers have concluded that the City does not need a guarantee, saying that local sources of funds are adequate to meet the City's financial needs. And in a sense, this is true. Identifying sources of funds, unfortunately, is not the same thing as getting the funds. While local institutions obviously have the ability to meet the City's financing needs, the ability to lend and the willingness to lend are not synonymous. The failure of the November offering points up the difference. That failure rather than a Committee report depicts financial reality. It reflects the lack of investor confidence in the City of New York.

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This lack of confidence is further reflected by the public statements of persons responsible for investing the sources of funds identified in the Four Year Financial Plan. The State Comptroller, citing his fiduciary responsibilities, has refused to invest substantial amounts in City securities. The consultant on pensions to several municipal unions stated at this Committee's hearings last week that he would not invest in additional City securities without a Federal guarantee. Mr. Elmore Patterson, Chairman of the Executive Committee of Morgan Guaranty Trust Company of New York, said "if there is no federal assistance after June 30, I do not feel very hopeful about raising any additional money from these local sources which act in the capacity of depository or fiduciary for the people's money." Mr. John A. Raben, President of the Savings Bank Association of New York State, also spoke of fiduciary responsibilities in his testimony before this Committee.

In addition to the above statements, the City has been informed by MAC that the City could not expect to enter the public credit markets in the near future. Thus, the advice we receive from bankers and financial advisors is nearly unanimous -- the City does not have access to the marketplace.

We designed the Four Year Financial Plan to make the City creditworthy. The Plan presents a comprehensive approach by which the City can achieve a truly balanced budget by fiscal year 1982. But restoring the City's access to the public credit markets will require firm long-term and short-term financing commitments to sustain the City during the four-year period ahead.

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Basic to the plan is the concept of a City-State-Federal partnership. It calls on all levels of government to continue, and to increase, their efforts to solve the City's long-term problems.

The State of New York has been asked to help because under our Federal system, states have primary responsibility for cities within their jurisdiction.

The Federal Government has been asked to help because many of the problems confronting the City are national problems. Like most of the nation's older cities, New York is faced with a deteriorating economic base, a changing population and stagnating property values. In addition, many of the problems faced by our older cities were shaped by national trends. For example, the City's share of welfare and Medicaid payments -- $1.2 billion -- is greater than its budget gap in accordance with generally accepted accounting principles.

The Four Year Financial Plan asks Washington and Albany to contribute a total of nearly $300 million in additional aid during the next fiscal year, with this amount to recur in slightly increasing amounts over the life of the Plan.

I am happy to report that the Governor and the State legislative leaders have agreed on the State's share of this $200 million effort. The precise details of this aid are being worked out and I am assured that the monies will be forthcoming.

We also have held discussions with the Administration regarding the Federal share of the increased aid package -- in particular, we will be pressing for a continuation of the New York City countercyclical revenue sharing program as the principal source of increased Federal assistance in 1979.
Over the long term, we believe that a fundamental change in the Federal and State share of welfare and Medicaid assistance will be necessary for the City to eliminate its budget gap.

I also want to make it clear that the Four Year Plan does not ask others to do what the City should do for itself. As I have said, the Plan is based on the idea of partnership. And during this four-year period, it is envisioned that actions taken by the City will account for 50 percent of the total gap to be closed.

The City is in the midst of preparing its fiscal 1979 budget. When our Executive Budget is submitted on April 15, it will include:

- A further reduction in the municipal work force through attrition -- yielding savings of $65 million in fiscal year 1979, $147 million in fiscal year 1980, $222 million in fiscal year 1981, and $280 million in fiscal year 1982;

- A cost control program in materials and supplies that will force a decline in real purchases of 12 percent over the four-year period;

- Management improvements based on audits developed by the City Comptroller;

- Changes in health service delivery and continuation of the City's successful cost containment program in the areas of public assistance and social services; and

- The elimination of unnecessary programs.

(more)
It is of course one thing to talk about taking such actions and quite another to effect them. I however want you to know that my Administration is intent upon implementing its part of the City-State-Federal partnership.

In fact, this coming Friday, I will announce specific actions totalling $174 million to implement the cost reductions for fiscal 1979 outlined above, which were originally included in the Four Year Financial Plan.

But closing the budget gap is only part of the Four Year Plan. The City must begin to rehabilitate itself to help preserve the tax base as a means of maintaining a long-term balance between revenues and expenses. Unless we repair our streets and fix our water mains, improve our drainage system and rebuild our subways, New York City cannot provide the quality of life essential to maintaining such a balance.

To renovate the City's physical plant, I once again have relied on the concept of intergovernmental cooperation. We are asking the Federal Government to guarantee, with State participation, bonds to be sold for true capital improvements.

The amount of such outlays over the next four years totals $2.6 billion. This is the level of capital expenditures which the City's engineers estimate is necessary to rebuild the physical plant and to construct essential projects. Unless these expenditures are made quickly, it may be too late to save what we already have. In that case, the future cost to rebuild what was not or cannot be repaired will be prohibitive.

To halt the deterioration of the physical plant, the Four Year Plan calls for the following rehabilitation program:

(more)
- Instituting a 35-year replacement cycle for streets, a 40-year cycle for bridge roadways, a 100-year cycle for City sewers and a 75-year cycle for water mains instead of at current levels of expenditure whereby the City's physical plant is rebuilt every other century;
- Doubling the investment for transit modernization;
- Replacing aging Police, Fire and Sanitation facilities;
- Renovating piers and markets; and
- Supplementing the two fifty-year-old existing water tunnels with a third tunnel.

The Four Year Plan also calls for capital spending to build water pollution control plants in Brooklyn and Manhattan. These outlays, it should be noted, are required to match State and Federal funds.

In addition to $2.6 billion for true capital projects, the City will need an equal amount over the next four years to relieve past financing pressure. This will include:

- $900 million to finance operating expenses in the capital budget; these items are a hold-over of past fiscal abuses and my Administration is committed to phasing them out of the capital budget twice as fast as permitted by law;
- $800 million to bond the State Advance; the Advance represents accumulated past deficits and bonding it will not only enable the City to end this abuse but it will permit the City and the State to reduce short-term borrowing needs;

(more)
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(more)
- $560 million to restructure MAC's debt by refunding MAC bonds; it will also provide budget relief of approximately $200 million over the four year period; and
- $250 million to meet MAC's capital reserve requirements which provide additional security for investors; if the capital reserve requirements cannot be bonded, budget expenditures will be increased by approximately $250 million over the next four years.

Thus, the City's long-term financing needs over the next four years total $5.1 billion -- $2.6 billion for capital improvements and $2.5 billion to relieve past financing pressures.

To meet these needs, the following sources of capital are suggested by the Four Year Plan:

($ in Billions)

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<td><strong>Total</strong></td>
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As previously noted, the Plan contemplates that the pension fund purchases of bonds sold to finance true capital expenditures will be guaranteed, with State backing, by the Federal Government.

However, it is not merely the pension fund purchases that will be affected if the Federal guarantee is not extended. The entire plan will be jeopardized. It will be jeopardized because all the parts are dependent on each other. Unless the budget gap is closed and a balance maintained, investors will not have confidence in the City's ability to meet its financial obligations.

(more)
Unless the physical plant is renovated, a long-term budget balance cannot be maintained. Unless as part of a financing package a Federal guarantee is extended, fiduciaries will be unwilling to risk the money that belongs to others. The guarantee is included in the Four Year Plan to increase investors' willingness to make some loans. When it is in place, the City can move to meet the balance of its long-term financing needs.

The same is true with the City's short-term financing needs. The City's short-term needs could be as high as $1.8 billion in 1979. They arise from the timing differences between collections and expenditures -- the City's expenditures are relatively equal each month while a disproportionate share of its revenues come in the fourth quarter. To obtain the funds that the City needs to meet its operating expenses, the City must turn to outside sources. There again, a high level of confidence will be the necessary factor in determining whether lenders are willing to extend credit. If we have Federal financing assistance, I feel certain that such credit will be forthcoming, at least in the amounts indicated in the Four Year Plan. Without assistance, our ability to secure credit is highly doubtful.

Of course, no one can predict the future with certainty. It is my belief however that a continuation of the seasonal loan program combined with a long-term guarantee will give the City time to achieve a record of balanced budgets while reducing past financing pressures so that it can enter the market on its own strength within the next four years.
II. CARTER ADMINISTRATION'S PROPOSAL

As you know last week the Secretary of the Treasury, W. Michael Blumenthal, submitted the Administration's proposal for the City of New York. Under this proposal, the Federal Government would replace the Seasonal Financing Act with a program to guarantee up to $2 billion in long-term City or MAC securities. The guarantee would last for up to 15 years and the City would pay a guarantee fee of 1/2 percent on any guaranteed security.

The guarantees would be issued only if the City met the following conditions:

- Submission of a four year plan that by fiscal 1982 will produce a balanced budget in accordance with generally accepted accounting principles;
- Creation of a fiscal monitor, to review the City's finances, with the monitor's powers to be at least as extensive as those of the Emergency Financial Control Board;
- Enactment of legislation to expand MAC's borrowing capacity so MAC can meet its part of the Four Year Plan; and
- Development of a plan whereby the Federal guarantees will be secured primarily by Federal transfer payments to the City and secondarily by New York State in a form such as by a State-funded debit reserve account and/or the pledge of an appropriate amount of certain Federal transfer payments to the State.

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The Federal guarantees will be issued only to the extent that the City cannot meet its long-term financing needs in the public credit markets. In addition, the issuance of the guarantees will depend on commitments by the investors to lend funds on an unguaranteed basis.
III. ANALYSIS OF CARTER ADMINISTRATION'S PROPOSALS

Although the Administration's recommendations do not in every respect fulfill the City's requests, they are a significant step toward a resolution to the City's financial problems. By guaranteeing the bonds that the City sells for true capital purposes, the Federal government will enable the City to undertake the renovation of the physical plant that is vital to its long-term health.

The City could reduce its capital spending by about $200 million by requesting a State agency to finance the proposed Convention Center. However, I urge the Committee not to reduce the amount of true capital projects any further since, as I have mentioned previously, the need for restoring and maintaining the City's plant is critical to the restoration of our fiscal stability.

In regard to the amount of the State advance to be funded, I believe the State Advance should be bonded out in full because it will reduce the City's seasonal borrowing needs. In addition, the Advance represents past financial abuses and, therefore, stands as a symbol to investors of the discredited practices of the past, practices I am determined to eliminate.

I also would hope that the Committee would consider extending the guarantee for the life of the bonds to be issued. This longer time-span would reduce the debt service in each year. A shorter guarantee, and hence a shorter term bond, would increase annual debt service, thus widening the budget gap. The

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shorter term also could force the City to refinance this debt just at the time when it is completing its financial recovery.

In regard to short-term financing, I ask the Committee to continue the Seasonal Financing Act. As you know, the chief route to insolvency for the City in the short run is the inability to pay its bills due to a lack of credit. While I do not intend to let the City slip into default, I believe that financial prudence demands that the City be assured of short-term funds by the Federal Government. We will do everything in our power -- accelerate the collection of real estate taxes, request an acceleration of State aid, attempt to sell notes publicly, try to arrange a line of credit -- to meet our seasonal needs. A continuation of the Seasonal Financing Act, however, would insure that the City could pay all its bills in the event that we are not successful in arranging for our short-term requirements in other ways.

With regard to long-term guarantees, it is essential that the City be able to effect the sale of guaranteed and unguaranteed bonds simultaneously. To the extent the Administration's proposal allows this, we support it.

In regard to many other segments of the Administration's proposal, I am in accord with Secretary Blumenthal. Prior to assuming office, I called for a continuation of the fiscal monitor. Members of my Administration currently are developing a plan that will detail the powers of the new monitor.

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In addition, legislation is being prepared to expand MAC's borrowing authority.

As for the State's participation, it could take the form proposed by the Carter Administration. This is a matter to be worked out between the Governor and the Legislature.

Finally, I want to state that I agree with the Secretary about the importance of the current municipal labor negotiations. The City recently has begun the process of negotiating new labor agreements with a coalition of union leaders representing most of the City's employees. I have stated to our union leaders that the new labor agreements must be paid for within the resources available to us, as set forth in the Four Year Plan. We have exchanged demands with the coalition, and we are hopeful that the collective bargaining process will lead to a settlement that is within our means.
IV. CONCLUSION

Since the fiscal crisis began in 1975, the City has taken many steps to insure that all its expenses fall within its means. These steps include:

- A reduction in the work force by 21 percent, or 61,000 positions, since 1975;
- The imposition of tuition at City University;
- The reduction of the welfare rolls to the lowest level in eight years;
- A 40 percent increase in the subway and bus fare;
- The elimination or deferral of certain benefits by City employees amounting to $41 million;
- The elimination of 25 fire fighting units;
- The withdrawal of the City's funding for 77 day care centers;
- The retention of independent accountants to audit the City's financial statements;
- The implementation of a new financial management and control system; and
- perhaps most important, the prospect of a balanced budget for the current fiscal year, ending June 30.

These contributions to our continuing fiscal recovery often were painful; they were made through the cooperation and sacrifice of virtually every sector of our City's life. In many cases, these accomplishments were gained at the expense of customary municipal services, employment benefits -- and employment itself -- and urban amenities previously taken for granted.

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Yet the City of New York, determined to set its house in order has taken these steps and will continue to take those steps necessary to carry forward our fiscal recovery.

In closing, I would like to make four observations and a promise.

Firstly, the City's Financial Plan is a starting line rather than the bottom line. It is a point of departure for negotiations that will enable the City to develop a workable financing program.

Secondly, I cannot say with certainty that the City faces imminent bankruptcy if Federal financing assistance is not available. Obviously, however the possibility exists. To me the consequences -- for the City, the State, the Federal government, the public credit markets and the foreign exchange markets -- are so great that I cannot conceive that responsible government leaders would even consider taking that risk.

Thirdly, I want to say that I agree with the Secretary of the Treasury that over the long run the cost to the Federal Government of not helping the City will be greater than the cost of helping. If the City does not rehabilitate itself, it will decay and slowly die, becoming a ward of the State and the Federal governments. In these circumstances, denying the City's request for financing assistance today will prove costly tomorrow. It is being penny-wise, pound-foolish on an incredible scale. On the other hand, a Federal guarantee can be as financially rewarding for the Federal government as the seasonal loan program has been because we have offered to pay a guarantee fee -- an insurance premium if you like -- on the principal amount guaranteed.

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The Senate Banking Committee has, as the Secretary of the Treasury, already noted New York's creditworthiness in reporting that "The City has an impeccable record of repaying its seasonal loans (and) has made tremendous strides toward putting its financial house in order in the past three years and is still likely to do more in the next few months." This, I submit, is a strong argument why the cost of the guarantee program to the Federal government will be small and the rewards -- rehabilitation of the nation's largest City -- great, so that such a program seems clearly within the national interest.

Fourthly, I want you to know that we are not looking for a handout. We are not asking for welfare. Rather we ask you to allow us to help ourselves. We are looking for a self-help program that will enable the City to achieve long-term viability.

Finally. So long as I am Mayor of the City of New York, the City will make every effort to see that the dollars it spends are spent well. Our citizens are tired of fiscal waste and high taxes. They are also tired of the abuses that have too long afflicted certain social programs. For these reasons, I pledge to you that my Administration will work night and day to see that the trust which you place in us is not betrayed.

Thank you.

# # #
Mr. Chairman, Honorable Members of the House Economic Stabilization Subcommittee:

Thank you for this opportunity to meet with you today. It is a privilege and a pleasure for me to appear as Mayor of the City of New York, before you, my former colleagues. My testimony this morning will consist of a lengthy, detailed statement -- which we have delivered to the Subcommittee in writing -- and a shorter statement which I will make at this time.

Since my election as Mayor, I have stated that the burden of proof is upon New York City to demonstrate the merits of its case for renewed Federal assistance. I accept that burden even though as a former member of this House I believed, as many of us did, that the passage of the Seasonal Financing Act of 1975 would eliminate the need for the City to ever return for help.

That hope, that feeling, that belief, unfortunately underestimated the lack of investor confidence in the City despite the fact that we:

-- reduced our workforce by 21 percent;
-- imposed tuition at City University;
-- reduced welfare rolls to the lowest level in 8 years;
-- increased subway and bus fares by 43 percent;
-- retained independent accountants to audit the City's financial statements;
-- implemented a new financial and management control system;

(MORE)
-- expect to achieve a balanced budget for the fiscal year ending June 30; and

-- repaid on time all borrowings under the Seasonal Financing Act - a profit to the Federal Government of approximately $30 million.

The Seasonal Financing Act also required the City to make a good faith effort to re-enter the private credit market. In November, 1977, we made that effort. Our lack of success is our primary reason for returning to the Congress today.

Despite our rigorous economies, despite my determination to end the shameful practices of the past, despite the new beginnings made by this City, the simple inescapable fact is that the lack of investor confidence in our City has precluded us from the normal source of financing -- the public credit markets.

Until the City truly balances its budget according to generally accepted accounting principles, this lack of confidence will remain; this is the reality. We accept that; our Four Year Financial Plan is a prescription for fiscal health. We are committed to take those steps necessary to achieve our goal and to eventually re-enter the credit markets on our own.

Basic to the plan is the concept of a City-State-Federal partnership. It calls on all levels of government to continue, and to increase, their efforts to solve the City's long-term problems.

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The State of New York has been asked to help because under our Federal system, states have primary responsibility for cities within their jurisdiction.

The Federal Government has been asked to help because many of the problems confronting the City are national problems.

The Four Year Financial Plan asks Washington and Albany to contribute a total of nearly $300 million in additional aid during the next fiscal year, with this amount to recur in slightly increasing amounts over the life of the Plan.

I am happy to report that the Governor and the State legislative leaders have agreed on the State's share of this effort. The precise details of this aid are being worked out and I am assured that the monies will be forthcoming.

We also have held discussions with the Administration regarding the Federal share of the increased aid package -- in particular, we will be pressing for a continuation of the countercyclical revenue sharing program as the principal source of increased Federal assistance in 1979.

I want to make it clear that the Four Year Plan does not ask others to do what the City should do for itself. As I have said, the Plan is based on the idea of partnership. And during this four-year period, it is envisioned that actions taken by the City will account for 50 percent of the total budget gap to be closed.

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The City is in the midst of preparing its Fiscal 1979 budget. When our Executive Budget is submitted on April 15, it will include:


- A cost control program in materials and supplies that will force a decline in real purchases of 12 percent over the four-year period;

- Management improvements based on audits developed by the City Comptroller;

- Changes in health service delivery and continuation of the City's successful cost containment program in the areas of public assistance and social services; and

- The elimination of unnecessary programs.

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It is, of course, one thing to talk about taking such actions and quite another to effect them. I, however, want you to know that my administration is intent upon implementing its part of the city-State-federal partnership. In fact, this coming Friday, I will announce the specific actions totalling $174 million to implement the cost reductions for fiscal 1979.

But closing the budget gap is only part of the Four Year Financial Plan. The City must begin to rehabilitate itself to help preserve the tax base. Unless we repair our streets and fix our water mains, improve our drainage system and rebuild our subways, New York City cannot provide the quality of life essential to a viable urban society.

The amount of such outlays over the next four years totals $2.6 billion. This is the level of capital expenditures which the City estimates is necessary to rebuild the physical plant and to construct essential projects. Unless these expenditures are made quickly, it may be too late to save what we already have. In that case, the future cost to rebuild what was not repaired will be prohibitive. For instance in 1977 the City paid out in judgments $17 million in damages resulting from water main breaks.

In addition to the above-stated amount for true capital projects, the City will need an equal amount over the next four years to relieve past financing pressure. This will include:

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--$900 million to finance operating expenses in the capital budget;
--$800 million to bond the State Advance;
--$560 million to restructure MAC's debt by refunding MAC bonds; and
--$250 million to fund MAC capital reserve requirements.

To meet these needs, the following lending sources are identified by the Four Year Plan:

City and State Pension funds -- $2.250 billion;
New York financial institutions -- $1 billion;
Public offerings -- $1.850 billion.

The plan contemplates that the pension fund purchases of bonds sold to finance true capital expenditures will be guaranteed, with state backing, by the federal government.

However, it is not merely the pension fund purchases that will be affected if the federal guarantees are not extended. The entire interdependent plan will be jeopardized. Unless the federal guarantee is in place, investors will not have confidence in the city's ability to meet its financial obligations.

The same is true with the city's short-term needs. These needs could be as high as $1.8 billion in 1979 as a result of the timing differences between collections and expenditures.

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As you know, last week the Secretary of the Treasury, W. Michael Blumenthal, submitted the Administration's proposal for the City of New York. Under this proposal, the Federal Government would replace the Seasonal Financing Act with a program to guarantee up to $2 billion in long-term City or MAC securities. The guarantees would last for up to 15 years and the City would pay a guarantee fee of one-half percent on any guaranteed security.

While the Carter Administration's proposals represent a significant step toward the resolution of the City's financial problems, they do not in every respect fulfill the City's needs.

For example although we propose long term needs of $5.1 billion, the Administration recommends $4.5 billion. While we propose a guarantee of $2.25 billion of City bonds, the Administration recommends only $2.0 billion.

While we propose to bond out the full amount of the State advance, the Administration recommends only half of the advance be bonded.

Although the Administration proposal limits the life of the guarantee, we now ask that the guarantee be tied to the life of the bond.

Despite the Administration's position, we ask the Committee to extend the Seasonal Loan program to assure the flow of short-term funds. While we will do all in our power to reduce our seasonal needs, the continuation of the federal Seasonal Loan program will ensure that the City has adequate monies on hand to pay our bills.

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However, we agree with Secretary Blumenthal’s proposal for the continuation of a fiscal monitor. In fact, prior to assuming office I called for just such a step. Members of my Administration are currently developing a proposal which will detail the powers of the new monitor.

To the extent that the standby guarantees proposed by the Administration allows us the flexibility to package both guaranteed and non-guaranteed bonds simultaneously we support that recommendation.

We in the City of New York have taken many painful, often unpopular, measures to regain our fiscal solvency. We now look to the future, to the day when our City will re-enter the market on its own; when solvency, fiscal health and wellbeing, and adequate financing sources will be commonplace occurrences and not daily worries. This City will emerge, eventually, from this crisis leaner, wiser and stronger. We know now that we must live within our means; that a budget is an honest financial document and not a political wishing well.

I pledged to the people of my City that I would guard every dollar entrusted to my stewardship. I pledged that public money would be spent wisely for legitimate public purposes. I intend to keep those pledges. The shabby practices of the past have no harbor in my Administration. I intend to give the people of New York a realistic, no-nonsense Administration, and I pledge to you that the assistance extended to us by this great Congress will be a sound investment in a going concern, my City, the City of New York.

Thank you.

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