VOLUNTARY MUNICIPAL REORGANIZATION ACT OF 1975

REPORT
OF THE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE
TO ACCOMPANY
S. 2615
TOGETHER WITH MINORITY AND ADDITIONAL VIEWS

November 4, 1975.—Ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1975
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

WILLIAM PROXMIRE, Wisconsin, Chairman

JOHN SPARKMAN, Alabama
HARRISON A. WILLIAMS, Jr., New Jersey
THOMAS J. McIntyre, New Hampshire
ALAN CranSTON, California
ADLAI E. STEVENSON, Illinois
JOSEPH R. BIDEN, Jr., Delaware
ROBERT MORGAN, North Carolina

KENNETH A. MccAIN, Staff Director
ANTHONY T. CLEEF, Minority Staff Director
ROBERT E. WEINTRAUB, Professional Staff Member
ELIZABETH BACHRACH, Professional Staff Member

(II)
CONTENTS

I. History of legislation.................................................................................................................. 1
II. Summary of the legislation......................................................................................................... 1
III. Need for the legislation............................................................................................................. 3
IV. Background of the New York City crisis
   A. Causes of the crisis.................................................................................................................. 6
   B. Comparative figures on New York City.................................................................................. 8
   C. Steps New York City and State have taken to avert default.................................................. 30
   D. Potential for default.............................................................................................................. 11
V. Economic impact of a New York City default
   A. On the city............................................................................................................................. 12
   B. On the State.......................................................................................................................... 14
   C. On the municipal bond market............................................................................................. 15
   D. On the banking system.......................................................................................................... 20
   E. On the economy..................................................................................................................... 23
VI. Policy options considered by the committee.......................................................................... 24
VII. Section-by-section analyses of the bill.................................................................................. 30
Minority views of Messrs. Tower, Brooke, Helms, Garn, and Morgan........................................ 37
Additional views of Mr. Brooke...................................................................................................... 42
Additional views of Mr. Helms....................................................................................................... 43

TABLES
1. New York compared to other cities: Per capita expenditures, employment and other data............................................................................................................. 8
2. New York compared to other cities: Salaries........................................................................... 9
3. New York City's borrowing needs............................................................................................ 12
4. Ratio of yields on long-term tax-exempt securities to yields on Long-term taxable corporate securities............................................................................................................. 16
5. Yield spread between high quality (Aaa) and low quality (Baa) long-term tax-exempt securities.............................................................................................................. 17
6. Cities with an A or lower bond rating....................................................................................... 19
7. Special survey of New York City obligations, to October 31, 1975........................................ 21

(iii)
I. History of the Legislation

The Committee on Banking, Housing and Urban Affairs held hearings on October 9, 10 and 18, 1982, S. 2672, S. 1833, and other proposals to provide loan guarantees or other financial assistance to local governments.

The Committee met in open markup session on October 21 and 22 to consider three proposals: Option One, to prevent a New York City default by a Federal guarantee of MAC securities; Option Two, to enact a temporary stand-by program of Federal assistance in the event of a default; and Option Three, to take no action on the New York City fiscal crisis at the present time. On October 21, the Committee agreed by a vote of 7-6 to consider Option One.

After discussions and deliberations, the Committee decided to hold one additional day of hearings in October 23, in order to obtain further testimony on the financial condition of New York City and on alternative means of dealing with the problems posed by the City's fiscal crisis.

The Committee met again in open markup session on October 24, 25, 28, and 30, to consider Option One, as revised by Senator Stevenson to include a procedure for restructuring New York City's debt obligations, and other proposals pending before the Committee.

On October 30, the Committee reported out Option One (Revised) by a vote of 8-5. In previous actions, the Committee rejected motions by Senator Brooke to adopt Option Two in the nature of a substitute (by a vote of 7-6) and to strike the pre-default guarantee authority in Option One (Revised) (by a vote of 9-4).

II. Summary of the Legislation

The Voluntary Municipal Reorganization Act is designed to restore the financial health of New York City with minimum Federal involvement. It requires the City to balance its budget and follow sound fiscal disciplines; it establishes a voluntary method for reorganizing the City's debt; it subjects the City's financial affairs to the close accounting of a Federal Board headed by the Secretary of the Treasury; it provides guarantee assistance for meeting the City's borrowing needs until it has regained investor confidence; and as an alternative if default occurs, it provides temporary assistance to meet essential services.

The bill is intended to achieve the same fiscal reforms recommended by the President but without the need for judicial proceedings under the Bankruptcy Act. In so doing, it would avoid the adverse consequences of a default on the municipal bond market, on other cities or States, and on the national economy. The bill also assures that Federal involvement will be phased out at the earliest possible date, and in any event no later than four years.

The main provisions of the legislation are as follows:

1. Authorizes $4 billion in Federal guarantees of new State securities in order to prevent a New York City default. The securities guaran-
tended would be limited to a one-year maturity. The guarantee authority would be phased out over a four-year period so that the maximum amount outstanding would be $4 billion through June 30, 1977; $3.5 billion through June 30, 1978; $2.5 billion through June 30, 1979; $1.5 billion through June 30, 1980; and zero thereafter.

2. Establishes a three-man board to administer the guarantee program consisting of the Secretary of the Treasury as chairman, the Chairman of the Federal Reserve Board and the Secretary of Labor. In addition to the specific requirements of the bill, the board is authorized to impose such additional terms and conditions as it deems appropriate as a precondition for guarantee assistance.

3. Requires a voluntary restructuring of the City's debt as a precondition for guarantee assistance.

At least 65 percent of the present MAC obligations must be exchanged for non-guaranteed bonds with longer maturities and lower interest rates ($2.2 billion).

At least 40 percent of the City's obligations maturing before June 30 must be exchanged for similar long-term, low interest rate bonds ($1.2 billion).

4. Requires the City and the State to meet stringent conditions before obtaining a guarantee.

The board must determine that neither the City nor the State is able to obtain credit from other sources and that a default is imminent.

The City must submit a financial plan for achieving a balanced budget by July 1, 1977. The plan must provide for reductions in the cost of employee pension plans, and maximum feasible participation by employee pension funds in the restructuring of the City's debt.

The State must assume control of the City's fiscal affairs for the entire period during which the Federal guarantee is outstanding.

The guarantee must be secured by future Federal revenue sharing payments to the City and State, to assure repayment of any losses sustained by the U.S. government.

The City must open its books to the Federal government and follow proper accounting practices, as prescribed by the Board.

The State must cover one-half of the City's operating deficit out of general tax revenues, over and above any assistance given previously.

The State must pay a guarantee fee of up to 3 1/2 percent of the total amount of obligations guaranteed. However, the fee will drop to 1 percent if the obligations are made taxable rather than tax-exempt.

5. Establishes a stand-by guarantee program to meet the City's short-term credit needs for continuing essential services, in the event the stringent preconditions are not met and the City defaults. Assistance under this stand-by program is limited to $500 million on three-month City notes and the authority expires on March 31, 1976.
III. NEED FOR THE LEGISLATION

The Committee believes that in the absence of Federal assistance, a default by New York City on its outstanding obligations is almost certain. A New York City default is likely to trigger defaults by New York State agencies, and possibly by the State itself.

A New York City default is probable because the credit markets are now closed tight against the City and it cannot borrow to meet its cash flow and debt service needs. Between December 1, 1975, and June 30, 1976, the City must roll over $2.6 billion in short-term debt and fund an operating budget deficit of $500 million and a $1 billion capital program. If it cannot borrow to cover this $4.1 billion, New York City will have no choice but to default on its obligations as they come due. And on December 11 it faces a debt roll-over of $400 million.

New York State has severely strained its own resources to shore up the City, and their fates are now closely linked. The State's credit rating dropped, and there is every indication that the market is closing to the State and its agencies. The Housing Finance Agency faces default in mid-November because it cannot borrow to cover $100 million in notes coming due. If the City defaults, there is little likelihood that the State agencies will be able to borrow the $2 billion they will need by the end of the fiscal year. New York State itself has no major borrowing needs at this time, apart from $130 million to complete the package to help the City through to December. In the spring, however, it will have to borrow $3.5 million in tax anticipation notes in order to make State aid payments to its municipalities. If it cannot market these notes, it will not meet those payments, and the loss of State assistance payments could trigger a wave of municipal defaults throughout the State. Already cities such as Yonkers are finding it hard to market their bonds, due to the contagion of the New York City crisis.

On the basis of its findings and deliberations over the past few weeks, the Committee is now convinced that the basic question is not whether to provide Federal assistance to New York City, but rather when and how much. There is no way that New York City could survive default and avoid a collapse of vital city functions without assistance from the Federal government, which means financial aid in some form. The Committee believes that the costs of default or bankruptcy would be far higher than the costs of preventing default—for New York City and State, for other States and municipalities across the country, for the banking system and the economy, and above all, for the taxpayer, who ultimately pays the bill.

The immediate consequences of default would be disastrous for New York City. Even if it made no debt service payments, the City would still be short about $1.2 billion for the period from December through March, due to seasonal shortfalls in revenues as well as the overall budget deficit. This represents about one-half of the controllable items in the City's budget. It would mean payrolls unmet and massive layoffs of city workers, school closings, no pay-outs for supplies to hospitals and prisons, vendors to the City driven into bankruptcy, abandoned construction sites.
Default is likely to cripple the City and halt its progress toward fiscal stability. First, it will mean a sharp decline in tax revenues. If the City fails to pay debt service, it could lose the 13 percent of its real estate taxes earmarked for this purpose. Tax delinquencies could shrink off $300 million at least. Income and sales tax collections will drop due to loss of jobs and businesses. An expected advance of $800 million from the State probably would not be paid. Legal problems could block Federal and State welfare and Medicaid payments, if the City cannot meet its matching contributions. All told, the City's cash deficit through June 20 could exceed $2 billion.

Default will impair the City's ability to re-enter the private capital market for years to come. The market for City securities would be drastically reduced. Thirty States have laws prohibiting fiduciaries and financial institutions from investing in bonds of a city that has defaulted for as long as ten years and, in some cases, 25 years after the event. With the capital market closed, New York City will need permanent financial aid from the Federal government.

Consequences of default for New York State would be similar—cuts in jobs and services, fall-off of tax revenues, especially from the City, and long-term banishment from the capital markets. If the State agencies, which finance major construction projects, go under, then the landscape will be “spotted with empty monuments to default,” as Governor Carey put it.

The longer-term “ripple effect” of a New York City default on the municipal bond market is hard to gauge exactly, but expert testimony before the Committee gave compelling evidence that the impact could be profound and long-lasting. States and municipalities across the country, particularly those with less than top grade ratings, would have trouble marketing their bonds. Even those municipalities which continued to have access would face a disorganized bond market for at least six months, and long after that, they would have to pay a premium for credit. The estimates are that State and local borrowers would have to pay an additional interest cost of $300 million per year for the foreseeable future due to a New York City default. The total cost over the life of the bonds issued could exceed $1.5 billion.

In relative terms, a New York City default would be equal in magnitude to all of the municipal defaults which occurred during the Depression and would be about one-half the size of all local governmental defaults during that period. A financial disaster on this scale could cripple the financial markets and cast doubt on all “full faith and credit obligations.” This can only lead to higher interest, which in turn means higher State and local taxes which all of us will have to pay.

The banking system will be jolted by a default of New York City, and still more so if the State defaults as well. An estimate of the number of bank failures which could occur, according to testimony given by the three bank regulatory agencies, includes 22 national banks, 30 nonmember banks, and 17 State member banks. A far larger number would find their capital seriously impaired. The banks in danger of failing are predominantly smaller institutions scattered throughout the country; only a few are in New York State. The agencies supplied a list of the States affected but would not reveal the names of the individual banks, for fear of touching off runs on those banks. Although it appears that the banking system as a whole could
absorb the impact of default without major disruption, the effect could be devastating on a number of towns and cities throughout the country.

The nation's economy is just beginning to grope its way out of the severest downturn since the great Depression. A New York City default could seriously affect the recovery now underway. According to economic projections which the Committee received, the minimum loss of GNP would amount to $1 billion. If the municipal bond markets are further impaired as a consequence of default, the GNP loss could go nearly $20 billion, and 300,000 to 400,000 more people would be put out of work. This would arise primarily from the substantial cutbacks in State and local spending that would have to occur. No claims were made that the economy would be driven back into recession by a New York City default, but the consensus of the economists was that the recovery would be slowed down and that default coupled with other damaging developments could tip the balance against recovery.

President Ford has proposed amendments to the Federal Bankruptcy Act as his answer to handling New York City's financial crisis without involving the Federal Government. The President's plan cannot work without Federal financial assistance, and it is liable to lead in the long run to a far greater and longer lasting involvement of the Federal government in the financial affairs of the City.

In his statement, the President claimed that the City could meet its immediate financial needs post-default by issuing and selling certificates of indebtedness authorized by a bankruptcy court. Members of the Committee agreed unanimously that no one would buy those certificates in the absence of a Federal guarantee. With the City in chaos and its revenues falling away, how could anyone be expected to buy those certificates? Thus a Federal guarantee of New York City's obligations in some form, whether before or after default, is unavoidable.

For these reasons, the Committee approved legislation providing a very strict, very limited Federal guarantee of New York City's obligations, with a number of tough conditions attached.

The bill reported is in no way a "bail-out" of New York City. On the contrary, it imposes the same tough fiscal reforms and debt restructuring that might be achieved in a bankruptcy court after years of litigation. Rather than place the burden on the Federal government, it requires the banks and other investors to bear a large share of the risk by purchasing an increasing volume of unguaranteed City bonds. Moreover, it sets up a specific timetable for phasing out Federal guarantee assistance. The commitment of assistance after default under the President's program, by contrast, might well be open-ended.

The legislation is aimed at preventing default, because the Committee believes that prevention of default is the only way to get New York City back on its financial feet within a reasonable period of time and limit the Federal Government's financial involvement. However, in the event that a default does occur, the legislation also provides temporary emergency Federal assistance to maintain essential services.

The Government will not lose money under the Committee's bill. On the contrary, it will make money. The guarantee would be secured against any losses by the State and City's revenue sharing entitlements (about $500 million a year) and by a first lien on the City's
tax revenues. Furthermore, the guarantee fee charged will earn money for the Federal government. If it remains at \(5\%\) on tax-exempt securities, then the Government will take in over $400 million in revenues over the life of the guarantee. If the securities are made taxable and the guarantee fee drops to 1 percent, which is preferable from the standpoint of the bond market, then the government will still gain over $100 million plus an equivalent amount of additional tax revenues.

The Committee firmly believes that providing a Federal guarantee to avoid default is the best approach to the New York City problem. The terms of the bill, if enacted and carried out, should tide the City over the immediate crisis and bring it back into the credit markets with a minimum of disruption.

IV. BACKGROUND OF THE NEW YORK CITY FISCAL CRISIS

A. CAUSES OF THE CRISIS

Immediate Causes

The cause of New York City's current fiscal crisis is that it is unable to borrow money by selling securities in the private market. There has been a profound loss of investor confidence in the credit-worthiness of the City and in its prospects for curing the many problems which beset it—a mounting budget deficit, a tradition of bad management, escalating labor and pension costs, a growing poverty population and a declining revenue base.

New York City, like most State and local governments, has to borrow to finance capital improvements and to handle cash flow problems arising from seasonal imbalances in revenue receipts. The city has become unique, however, in the volume of its debt outstanding and particularly in the amount of short-term debt which it must roll over year by year.

Most cities issue some short-term notes, to tide them over until anticipated revenues come in or to fund capital construction when long-term interest rates are too high. New York City, however, now relies far more heavily on short-term borrowing than other cities. The city has consistently run a deficit in its operating budget in recent years, and it has borrowed short-term to fund that deficit. As a result, it must roll-over $2.5 billion short-term debt between December 1, 1975 and June 30, 1976. In addition, during this same period, the city faces a deficit of about $600 million on current account and $1 billion to finance the capital program. If New York City cannot borrow to cover these needs, it will have to default on its obligations as they come due. Given that the credit markets are no longer open to the City on any terms, and that alternative sources of funding are drying up, default is likely in the absence of any Federal assistance.

Roots of the Crisis

There is no doubt that many of New York City's problems are largely of its own making—the result of bad management and fiscal legendarian, carried on over the years by numerous public officials. Under State law, the City has to balance its budget, and the State has to certify that the City has done so. In fact, the City was running up an ever-increasing deficit, and State and City officials came up with various fiscal gimmicks to get around the balanced budget requirement. Deficits were funded by short-term borrowing in anticipa-
tion of revenues that would never materialize. Operating expenses were piled into the capital budget and funded through long-term borrowing. All this just postponed the day of reckoning.

Banks and other investors, who normally play the watchdog role in such situations, failed to do so. They should have known for some time that the City's financial affairs were not in good order. But they kept on promoting and buying New York City paper as the interest rates went higher and higher, until finally the city's debt became unmanageable and investors closed the door to further borrowing.

Another factor which has received widespread attention is the large growth in the number of New York City employees, and in the pay which they receive. The City now has 398,2 employees for every 10,000 residents, far more than any other city in the country except Washington, D.C. Its employees are also among the highest paid. Their pension benefits are indisputably higher, with virtually no employee contributions required, and no one can claim that pension liabilities are adequately funded in the City's present budget.

Finally, New York City provides a wider range of services to its residents than do most cities. There is the city-wide university system with free tuition for all students, and the municipal hospital system, the public transportation system, the low and middle income housing programs. All these cost money and push up the budget deficit.

On the other hand, many of New York City's problems have been thrust upon it and are characteristic of all our older central cities. New York's difficulties stand out more because they are on so much larger a scale.

While the City's population has remained stable in numbers, it has grown poorer. The last 25 years have seen the flight of the affluent middle class to the suburbs and a large in migration from the South and Puerto Rico. According to a study by the Joint Economic Committee, the size of New York's poverty population has changed drastically since 1960—from one of the lowest in the country to the second highest. Out of 7.6 million residents, about one million are on welfare. Not only does New York City have the largest welfare population in the country, in absolute terms, but it also bears the largest welfare cost burden per client of any city. The City picks up 28 percent of the welfare bill, while for most cities, the State pays all or all but a tiny fraction of the non-Federal share.

While New York City's revenue needs have grown, its tax base has failed to grow in proportion. It has experienced a substantial loss of private sector jobs, with industries moving away to other parts of the country. The JEC study points out that from 1970 to 1973, a period in which total employment grew 7.4 percent nationally, New York City experienced a decline in total private sector employment of 6.2 percent.

Another problem is the slow growth in the City's residential property tax rolls. While some of this lag is attributable to demographic trends, there is no doubt that rent control has cut into property tax revenues, leading to deterioration in the housing stock and in some cases to abandonment and tax delinquencies.

There are immediate problems which have aggravated the existing situation and plunged New York City into its current fiscal crisis. The recession has taken a heavy toll on the City. As of June 1975, New York's unemployment rate stood at 11.4 percent, higher than most of
the nation’s largest cities and a full 4.6 percentage higher than the previous year, June 1974. Lay-offs of City workers will push that figure still higher. Since the City relies quite heavily on sales and income taxes (about 32 percent of receipts), its revenues fall with unemployment. Unemployment also adds to the welfare burden. And while the recession has shrunk the City’s revenue base, inflation has compounded the City’s expense problems.

B. COMPARATIVE FIGURES ON NEW YORK CITY

There is much to criticize with respect to New York City’s spending on public services, pensions and other employee benefits, and debt management. But it would be a mistake to infer from this that these salaries and service costs are out of line with other local jurisdictions. A Background Paper on “New York City’s Fiscal Problem,” issued by the Congressional Budget Office on October 10, 1973, brings this matter into perspective. It points out that New York’s spending appears high because the city provides many services that in other metropolitan areas are supplied by county government, school districts, or other specialized units of local government. All of these come directly out of the city budget, rather than being spread around the budgets of a number of local governmental units.

Table 1, which is reproduced from the Congressional Budget Office study, compares New York with other larger central cities in terms of spending for common municipal functions—education, highways, police and fire protection, sanitation, parks, and general administration. New York spends $423 per capita for these services and ranks fifth in the country, behind San Francisco ($488), Baltimore ($470), Newark ($449) and Boston ($411).

Table 1.—New York City compared to other large central cities, expenditures, employment, and other data

<table>
<thead>
<tr>
<th>City</th>
<th>Index of central city expenditure above average</th>
<th>Fraction of population receiving welfare payments</th>
<th>Central city government per capita expenditures 1972-73</th>
<th>Local government employment per 10,000 population 1974</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(a)</td>
<td>(b)</td>
<td>(c)</td>
<td>(d)</td>
</tr>
<tr>
<td>New York City</td>
<td>211</td>
<td>12.1</td>
<td>$924</td>
<td>$5335</td>
</tr>
<tr>
<td>Boston</td>
<td>195</td>
<td>16.9</td>
<td>$558</td>
<td>$441</td>
</tr>
<tr>
<td>Chicago</td>
<td>245</td>
<td>11.1</td>
<td>$657</td>
<td>$383</td>
</tr>
<tr>
<td>Cleveland</td>
<td>422</td>
<td>14.4</td>
<td>$927</td>
<td>$429</td>
</tr>
<tr>
<td>Detroit</td>
<td>768</td>
<td>16.5</td>
<td>$632</td>
<td>$360</td>
</tr>
<tr>
<td>Los Angeles</td>
<td>763</td>
<td>16.2</td>
<td>$553</td>
<td>$395</td>
</tr>
<tr>
<td>Philadelphia</td>
<td>763</td>
<td>16.2</td>
<td>$553</td>
<td>$395</td>
</tr>
<tr>
<td>San Francisco</td>
<td>763</td>
<td>16.2</td>
<td>$553</td>
<td>$395</td>
</tr>
<tr>
<td>New Orleans</td>
<td>128</td>
<td>11.4</td>
<td>$641</td>
<td>$358</td>
</tr>
<tr>
<td>St. Louis</td>
<td>231</td>
<td>15.8</td>
<td>$710</td>
<td>$394</td>
</tr>
<tr>
<td>Boston</td>
<td>245</td>
<td>11.1</td>
<td>$657</td>
<td>$383</td>
</tr>
</tbody>
</table>

1 Central county.
2 Common municipal functions include elementary and secondary education, highways, police, fire, sanitation, parks, central control, and financial administration.
New York has become notorious in recent months for its numerous public employees, but the table shows that New York employment per 10,000 residents for the common municipal functions is 2,229, which is less than Newark (2,582), Philadelphia (2,562), San Francisco (2,446) and Baltimore (2,601).

What about salaries? Table 2, also from the Congressional Budget Office study, compares the average salaries of public employees for our twelve largest cities. The table confirms that New York’s sanitation workers, referred to often in hearings and in the press, are indeed the highest paid in the country. It also shows that other cities pay their employees more than New York does in some categories. Los Angeles and San Francisco both pay their firemen more on an average, and Detroit pays its policemen more. New York’s teachers rank fourth on the comparative pay scale. They earn an average of $17,410 a year, as compared with Detroit’s teachers at $22,003, Chicago’s at $21,891 and St. Louis at $17,543.

<table>
<thead>
<tr>
<th>City</th>
<th>Teacher</th>
<th>Police</th>
<th>Fire</th>
<th>Sanitation</th>
<th>Cost of BLS’s intermediate family budget</th>
<th>Debt outstanding per capita 1927-28</th>
<th>Total Short-term</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(a)</td>
<td>(b)</td>
<td>(c)</td>
<td>(d)</td>
<td>(e)</td>
<td>(f)</td>
<td>(g)</td>
</tr>
<tr>
<td>New York City</td>
<td>$17,440</td>
<td>$14,665</td>
<td>$16,964</td>
<td>$15,074</td>
<td>$116</td>
<td>1,265</td>
<td>734</td>
</tr>
<tr>
<td>Boston</td>
<td>16,276</td>
<td>14,352</td>
<td>13,846</td>
<td>10,086</td>
<td>117</td>
<td>734</td>
<td>334</td>
</tr>
<tr>
<td>Chicago</td>
<td>20,991</td>
<td>14,485</td>
<td>15,955</td>
<td>11,956</td>
<td>109</td>
<td>334</td>
<td>127</td>
</tr>
<tr>
<td>Newark</td>
<td>15,701</td>
<td>12,322</td>
<td>12,702</td>
<td>8,473</td>
<td>116</td>
<td>127</td>
<td>113</td>
</tr>
<tr>
<td>Los Angeles</td>
<td>15,705</td>
<td>15,833</td>
<td>21,120</td>
<td>13,608</td>
<td>28</td>
<td>113</td>
<td>113</td>
</tr>
<tr>
<td>Philadelphia</td>
<td>17,906</td>
<td>16,354</td>
<td>14,069</td>
<td>12,107</td>
<td>107</td>
<td>113</td>
<td>113</td>
</tr>
<tr>
<td>San Francisco</td>
<td>15,743</td>
<td>12,584</td>
<td>17,705</td>
<td>12,093</td>
<td>105</td>
<td>113</td>
<td>113</td>
</tr>
<tr>
<td>New Orleans</td>
<td>16,458</td>
<td>10,246</td>
<td>10,645</td>
<td>4,704</td>
<td>NA</td>
<td>113</td>
<td>113</td>
</tr>
<tr>
<td>St. Louis</td>
<td>16,762</td>
<td>11,748</td>
<td>11,885</td>
<td>9,903</td>
<td>97</td>
<td>113</td>
<td>113</td>
</tr>
<tr>
<td>Detroit</td>
<td>13,815</td>
<td>12,907</td>
<td>10,498</td>
<td>10,218</td>
<td>85</td>
<td>113</td>
<td>113</td>
</tr>
<tr>
<td>Baltimore</td>
<td>17,722</td>
<td>10,028</td>
<td>10,640</td>
<td>8,125</td>
<td>103</td>
<td>113</td>
<td>113</td>
</tr>
<tr>
<td>Detroit</td>
<td>21,603</td>
<td>15,636</td>
<td>10,107</td>
<td>13,814</td>
<td>104</td>
<td>113</td>
<td>113</td>
</tr>
</tbody>
</table>

1 Central county.

Sources:
2. Department of Health, Education, and Welfare, recipients of public assistance money payments and amounts of such payments by program, State, and county, February 1975, R-1045, No. 50, OCPS. Includes AFDC and general assistance recipients.
3b. Same as 3.

All this is not to say that there are no problems with New York’s public employment. The Committee is concerned about the number of employees, the size of salaries, and particularly the amount of fringe benefits New York offers, such as non-contributory pensions. There have been cutbacks already, and there will have to be more cutbacks as New York goes down the hard road to fiscal accountability. But the image of profligate New York outspending everybody on everything is not entirely accurate.
The welfare problem deserves a separate mention. While in most cities the State picks up the entire non-Federal share, including personnel and payroll, New York City foots a quarter of the nation's highest welfare bill, and all the city's welfare workers and their salaries appear in the City's budget. Compare this with cities like Boston and Philadelphia, where the State pays for all welfare costs, and New York City's budget takes on a different perspective.

A final set of figures casts light on another aspect of New York City's problem. That is the relatively small amount of Federal money which the City receives, as compared with its population and its great needs. A number of witnesses at the Committee's hearings pointed out that General Revenue sharing and other Federal grant programs are based on formulas which discriminate against the largest cities with the greatest problems. New York City, the biggest of them all, has also been one of the hardest hit, as an analysis of figures indicating Federal share of total city revenues will show. In fiscal year 1974, the latest figures available, the Federal government contributed 3.8 percent of New York City's total revenues from all sources. This is by far the lowest of any of the 29 largest cities. The average Federal contribution to those cities' total revenues was about 15 percent, and many were higher: Portland, Oregon at 19.9 percent, Chicago at 17.7 percent, Phoenix at 19.5 percent, and Pittsburgh at 30.6 percent.

C. STEPS NEW YORK CITY AND STATE HAVE TAKEN TO AVOID DEFAULT

Once you've gotten a bad reputation, it's hard to live it down. Thanks to being in the spotlight for its financial distress, New York City has come to symbolize fiscal frivility and bureaucratic extravagance.

But, in fact, the City and State in tandem have undertaken a mammoth effort in the last six months to restore fiscal discipline and bring the city back into the credit markets. All the necessary first steps have been taken to arrive at a balanced budget and sound accounting practices. Unfortunately, time is needed before real results can be shown, and time is what New York City does not have at this point. The progress of reform has not been kept pace with the decline of market confidence, so the footholds the City and State have carved on the path to stability are being eroded by the encroaching wave of default.

What steps have been taken to date?

In the Spring, when the market for short-term City debt first closed, New York State advanced to the City about $800 million in payments the City was due to receive from the State at the beginning of the next fiscal year. This tided the City over the immediate financial crisis.

Subsequently, the State created the Municipal Assistance Corporation (MAC), designed to give the city some access to the credit markets and to refinance some of the city's short-term debt on a long-term basis. Part of the City's revenue stream was diverted to MAC, to secure the obligations issued. In a further effort to restore investor confidence, MAC was mandated to work with the city to institute budgetary and managerial reforms, with a view to restoring fiscal integrity.

In the meantime, city employees agreed to a one-year wage freeze during the fiscal year beginning on July 1.
By the end of the summer, it became apparent that the MAC effort would not suffice to get the City back into the credit markets. The State Legislature then met in Special Session in September and took extraordinary steps to save the City from default and force it to make progress toward a balanced budget. The Legislature took the following actions:

- It approved a commitment of State and pension funds to meet the City's financing requirements until December 1, 1975.
- It appropriated $550 million of State funds to help the City.
- It adopted a measure mandating the City to arrive at a balanced budget in the fiscal year ending June 30, 1978, and to show substantial progress toward balancing its budget in fiscal year 1976 and fiscal year 1977.

To direct this major effort to steer the City away from the shoals of default, the Emergency Financial Control Board (EFCB) was established, with full power to direct the City's three-year Financial Plan. Members of the Board include the Governor and the State Comptroller, the Mayor and City Comptroller, and three management leaders from the private sector. The effect of this action has been to put the entire administrative machinery of New York City into trusteeship of a Board with extensive powers to determine all revenue estimates, receive all City revenues into its own account and disburse them only in accordance with the financial plan, review and pass on all major contracts, approve all City borrowing, and extend a freeze on wages through fiscal year 1977.

In keeping with its new powers, the Board has already rejected a major labor contract negotiated with the city's teachers. It has also reviewed and approved a three-year plan for reaching a balanced budget by fiscal year 1978 and cut $390 million out of the city's capital budget for the three-year period.

Since the first of the year the City has reduced employment by 31,000, a cut of over 10%. It has reformed its accounting practices, raised subway fares by 43%, increased taxes by $390 million, and installed a new Deputy Mayor for Fiscal Affairs drawn from private industry.

D. POTENTIAL FOR DEFAULT

In the absence of Federal assistance, a default by New York City on its outstanding obligations is likely to occur, possibly by December 11. The markets are shut tight against the City, and the City cannot survive if it is unable to borrow.

The countdown for those borrowing needs proceeds inexorably. On October 17, the City hovered on the brink of default as it scrambled to roll-over $420 million in short-term notes coming due. Only a last-minute infusion of teachers' pension funds kept the City going. On December 11, the City has to find another $438 million, to roll over debt and make interest payments.

Numerous witnesses before the Committee testified that the December 11 borrowing needs are not likely to be met out of the current resources of the City and State. Felix Rohatyn, Chairman of the Municipal Assistance Corporation, now charged with the responsibility of covering the City's borrowing requirements, gave this measured assessment of the City's standing on that date.
If we do reach December 1, we will have raised close to $4 billion, involved the state to the extent of $750 million, and scraped every known resource available to MAC. The City and the State. By December 1st there may be some avenues still open to us in a limited way, but absent an assured financing mechanism that would enable us to fund out our three-year plan, the odds against our winning are exceedingly long.

Recently it was revealed that there are negotiations going on to use the assets in the city's pension funds as collateral for $4 billion in loans, which would be used to buy MAC bonds and thus tide the City over its short-term debt crises for the near future. Even if this plan can be worked out, which is questionable in light of the fiduciary responsibilities of the pension funds' trustees, the City will only have found a short-term remedy to its long-term problems.

New York City's borrowing needs through the end of this fiscal year, June 30, 1976, come to a total of $3.1 billion. The volume of borrowing is necessary to cover a debt roll-over of $2.6 billion, a capital program of $1.0 billion, and an operating deficit of $516 million. If the City can scrape through to the end of fiscal year 1976, and is unable to replace its maturing short-term debt with long-term securities, then it faces total fiscal year 1977 borrowing needs of $3.9 billion—and this is assuming that all the budget cuts contained in the Financial Plan are in fact carried out. In fiscal year 1978, the City will have to borrow $6.8 billion. Table 3 summarizes the relevant data. On top of all this there are the intra-year borrowing requirements of between $1 billion and $2 billion that the City faces continually, when it has to borrow to cover its immediate cash needs because of seasonal shortfalls in tax revenues.

<table>
<thead>
<tr>
<th>TABLE 3—NEW YORK CITY'S BORROWING NEEDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>(in billions of dollars)</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Fiscal year</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Debt roll-over</td>
</tr>
<tr>
<td>Operating deficit</td>
</tr>
<tr>
<td>Capital program</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>


There is no way that New York City can meet its financing needs if it cannot go into the market and borrow, and there is no reason to believe that the market will open up to the City if the resources available to it remain the same. Thus without Federal assistance of some sort, default is probable sooner or later, and sooner is more likely.

V. Economic Impact of a New York City Default

A. ON THE CITY

No one can say for certain what will happen if New York City defaults. The only thing certain is uncertainty—perhaps to the point of chaos at least for a short time.
Immediate Problems

Ira Milstein, of the law firm of Weil, Gotshal and Manges, retained by the City to handle the legal problems in the event of default, captured the spirit of this uncertainty as it faced the City's officials in mid-October. He told the Committee,

Nobody has ever defaulted before in this dimension or this size. This is not a big business going into default or a small business going into default. This is the City of New York going into default and there are a host of relationships which have existed between creditors and debtors and sellers and vendors to the city that have just existed for dozens and dozens of years because they exist.

Now when you go into default all of those relationships become open to question for the first time. Bank accounts can be attached. Setoffs can be claimed. Money that the City thought that it had ready to pay checks with might be grabbed by attachment or otherwise by somebody else. Welfare checks begin bouncing.

With all the planning in the world and with all the foresight in the world, since there's no form book to go to see what happens when a municipality the size of New York defaults, there isn't anybody who can tell you what happens the next day on the streets. Will the garbage men stay in the trucks—I don't know—if those checks are stopped? There were rumors yesterday that possibly they might not. Will the banks honor bank accounts or setoffs? I don't know. Nobody knows exactly what's going to happen until they are faced with that possibility. Will litigation begin as between various holders of securities contesting each other as to who has priority? Nobody knows because this never happened before.

City Comptroller Harrison J. Goldin described to the Committee what the City's cash situation would have been on that fateful day in October, and may well be in December, or at some other future date:

As I evaluated the cash flow on Friday, I discovered the following—

Nothing for hospitals, nothing for social services, nothing to pay vendors for the delivery of food, toiletries, essential supplies to the city facilities, nothing for any purpose whatever during the course of the ensuing week.

Default thus will create immense cash problems. If they aren't solved immediately, unimaginable chaos and hardship will surely ensue.

Longer Run Problems

The legal aftermath of default raises additional questions about the City's ability to keep going. The City would go into court, and the court is empowered to grant a 90-day stay of all litigation, while it works out a restructuring of the City's debt. However, there is still a possibility that the City will be required under law to meet its debt service payments out of current revenues before it pays for city services. Another legal question involves welfare and Medicaid payments—
n the City's budget. If the City cannot meet its matching contributions, then can the Federal and State contributions—50 and 25 percent respectively—be paid out? And once the 90-day stay expires, there is bound to be an onslaught of lawsuits from vendors, investors, and others whose legal connections with the City left them damaged by default. New York could be tied up for years in a maze of default-inspired litigation.

The most telling consequences of default are the longer-term economic consequences—the effects on the City's revenue stream and on its prospects for re-entering the credit markets.

If the City defaults and stops payments on debt service, its tax revenues and State aid will drop off sharply. A reduction of $1.3 billion for the seven months period, December through June 30, 1976, is far from unrealistic, and that means a loss of 20 percent of projected revenues.

The main impact will be a steep reduction in the real estate taxes the City could collect. Under the State constitution, all real estate taxes over 51/2 percent of assessed value have to be used to pay off debt service. If the City failed to use the tax monies for this purpose, because of default, then about 43 percent of the real estate tax levy—some $1.4 billion a year—might not be collectible.

Default would further depress the economy of New York, and the disruption could accelerate the loss of businesses and jobs. This means a fall-off in personal income, corporate and sales tax revenues.

Looming above all the other factors is the spectre of default shutting New York out of the credit markets for a generation. Thirty states have laws barring banks, savings and loans, insurance companies, and other institutional investors from buying the paper of a municipality in default for 5, 10, up to 25 years after the event. Other States might well pass similar laws in the wake of a New York default. This "leper effect" as Mr. Millestein termed it, could shut the City out of the credit markets for years to come, even if it were to balance its budget and pay off its creditors. And if New York cannot get back into the market, there is no way it can function without federal assistance.

B. ON THE STATE

The State of New York is now deeply involved in the City's financial problems, and a New York City default would undoubtedly take a heavy toll on the State. As was stated before, a default by the Housing Financing Agency and other "moral obligation" agencies of the State is quite probable at this point. If the City and the agencies go under, the State and its larger municipalities could well be pushed over the brink.

A default by the City would cause further budget problems for the State, which already faces a $300 million deficit. It would at minimum delay repayment of a $250 million loan extended by the State to the City. In addition, the City's budget reductions could also cut into State revenues, to the tune of $100 to $150 million.

More important, the State's access to the credit market could be closed if the City defaults. The State's full faith and credit securities have already met with stiff investor resistance, and a City default could close the market to the State altogether. New York State does
not have major borrowing needs until the second quarter of 1976, but at that time, it will have to borrow $2.7 to 3.5 billion to cover State aid payments to all localities around the State. If the State cannot borrow this money and make the payments at that time, then many local governments in New York could be pushed into default.

If New York State follows the City into default, similar disruption will ensue. Paychecks will bounce, State aid payments to localities will be cut off, confusion will abound. If the State agencies default, capital construction will be cut sharply. Governor Carey painted a grim picture when he told the Committee,

Our State will be spotted with empty monuments to default, partially built classrooms, dormitories, public and private hospital mental health facilities, day care centers, nursing homes, water pollution control facilities, and housing for low and middle income families, to name a few of the ongoing projects—will forever stand as only steel and concrete.

Our sick, our elderly, our children in need of education, our working mothers and all of our citizens will forever be denied the vital services those facilities were designed to provide.

Billions of dollars in capital will be wasted.

More than 53,000 workers who depend on these four agencies for their livelihood will be sent to the unemployment lines.

C. OR THE MUNICIPAL BOND MARKET

No one can speak with complete confidence about the impact of a New York City default on the rest of the municipal bond market. However, it is possible to examine recent developments in the municipal bond market and to draw reasonable conclusions about the effect that default would have in the future.

The municipal bond market has been characterized by a great deal of disorder over the last six months, indicative of the enormous uncertainty associated with New York City's financial crisis. Banks and other major institutional investors have greatly reduced their participation in the municipal bond market. Bond underwriters, faced with the prospect of being unable to re-sell securities to the public, have reduced their willingness to participate in syndicates. Even fiduciaries and trustees have exercised greater care in investment choices with the hope of avoiding investments that potentially could be regarded as unsafe or imprudent.

These recent developments have produced a market in which all issuers are paying higher interest rates on their bonds and notes. In fact, recent yields on municipal bonds are the highest in the history of the tax-exempt market.

This sharp increase in tax-exempt interest rates is documented when interest rates on tax-exempt and taxable securities are compared. As Table 4 shows, interest rates on all municipal bonds have risen substantially relative to interest rates on corporate bonds.

Contrary to popular belief, this rise in relative interest rates has affected all borrowers in the municipal bond market, from the highest
quality to the lowest quality. As Table 4 shows, the ratio of high quality municipal bonds to high quality corporate bonds has risen almost as much as the ratio for low quality issuers.

<table>
<thead>
<tr>
<th>TABLE 4</th>
<th>RATIO OF YIELDS ON LONG-TERM TAX-EXEMPT SECURITIES TO YIELDS ON LONG-TERM TAXABLE CORPORATE SECURITIES</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total¹</td>
</tr>
<tr>
<td>1970</td>
<td>0.735</td>
</tr>
<tr>
<td>1971</td>
<td>0.706</td>
</tr>
<tr>
<td>1972</td>
<td>0.685</td>
</tr>
<tr>
<td>1973</td>
<td>0.699</td>
</tr>
<tr>
<td>1974</td>
<td>0.687</td>
</tr>
<tr>
<td>1975</td>
<td>0.723</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>September</th>
<th>October</th>
<th>November</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975</td>
<td>0.700</td>
<td>0.782</td>
<td>0.729</td>
</tr>
<tr>
<td></td>
<td>December</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.699</td>
<td>0.706</td>
<td>0.691</td>
</tr>
<tr>
<td></td>
<td>November</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.681</td>
<td>0.692</td>
<td>0.685</td>
</tr>
<tr>
<td></td>
<td>December</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.726</td>
<td>0.748</td>
<td>0.711</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>January</th>
<th>February</th>
<th>March</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975</td>
<td>0.711</td>
<td>0.724</td>
<td>0.742</td>
</tr>
<tr>
<td></td>
<td>April</td>
<td>May</td>
<td>June</td>
</tr>
<tr>
<td></td>
<td>0.712</td>
<td>0.717</td>
<td>0.719</td>
</tr>
<tr>
<td></td>
<td>July</td>
<td>August</td>
<td>September</td>
</tr>
<tr>
<td></td>
<td>0.717</td>
<td>0.722</td>
<td>0.775</td>
</tr>
<tr>
<td></td>
<td>October</td>
<td>(1st 3 weeks)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.715</td>
<td>0.726</td>
<td>0.726</td>
</tr>
</tbody>
</table>

¹ Includes bonds that are rated Aa and A.

Since March, when New York was last able to market its own securities, interest rates on municipal bonds (which are exempt from the Federal income tax) have moved closer to yields on taxable issues, a development that affects the great uncertainty in the municipal bond market. In September and October, with New York’s financial problems reaching crisis proportions, this trend toward higher relative interest rates has been more pronounced.

This precipitous rise in tax-exempt interest rates is costing all State and local governments millions of dollars in added interest payments. According to estimates included in the Joint Economic Committee study, most tax-exempt borrowers are paying an extra fifty basis points in interest (one-half percentage point) on all of their issues. The added cost means that State and local governments will have to pay an additional $160 million a year until the bonds reach maturity. Since the average maturity for all tax-exempt bonds is ten years or longer, the total cost to all State and local governments will be $1.6 billion (or approximately $1 billion if these interest payments are discounted to present value) for the $32 billion worth of bonds issued this year. To the extent that bonds have maturities in excess of ten years, these costs will be greater.

In addition, short-term tax-exempt rates have risen 50 basis points, imposing an additional cost of $150 million a year according to JEC estimates. Thus, State and local governments will incur additional interest costs of $306 million this year and an additional $150 million a year for at least the next nine years.

While the rise in all tax-exempt interest rates has been significant, the problems are clearly the greatest for the lower quality issuers. As
Table 5 shows the spread between Aaa and Baa issues has almost doubled over the last year. This widening spread indicates greater investor skepticism about all but the most secure investments.

**Table 5.—Yield spread between high quality (Aaa) and low quality (Baa) long-term tax-exempt securities**

<table>
<thead>
<tr>
<th>Year</th>
<th>Yield Spread</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>.63</td>
</tr>
<tr>
<td>1971</td>
<td>.77</td>
</tr>
<tr>
<td>1972</td>
<td>.66</td>
</tr>
<tr>
<td>1973</td>
<td>.60</td>
</tr>
<tr>
<td>1974</td>
<td>.64</td>
</tr>
<tr>
<td>1975 (Average of first nine months)</td>
<td>1.12</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Month</th>
<th>Yield Spread</th>
</tr>
</thead>
<tbody>
<tr>
<td>September</td>
<td>.69</td>
</tr>
<tr>
<td>October</td>
<td>.78</td>
</tr>
<tr>
<td>November</td>
<td>.65</td>
</tr>
<tr>
<td>December</td>
<td>.85</td>
</tr>
<tr>
<td>January</td>
<td>1.06</td>
</tr>
<tr>
<td>February</td>
<td>1.07</td>
</tr>
<tr>
<td>March</td>
<td>.97</td>
</tr>
<tr>
<td>April</td>
<td>1.06</td>
</tr>
<tr>
<td>May</td>
<td>1.20</td>
</tr>
<tr>
<td>June</td>
<td>1.21</td>
</tr>
<tr>
<td>July</td>
<td>1.23</td>
</tr>
<tr>
<td>August</td>
<td>1.31</td>
</tr>
<tr>
<td>September</td>
<td>1.24</td>
</tr>
<tr>
<td>October (First three weeks)</td>
<td>1.27</td>
</tr>
</tbody>
</table>

Source: Federal Reserve Bulletin.

While greater investor prudence is a development that all members of the Committee support, it should be pointed out that this so-called prudence could impose severe strains on many large, old central cities. These cities, through no fault of their own, have been associated with New York’s problem. In general, they are efficiently managed cities that maintain balanced budgets and have reasonable borrowing requirements. But, if recent developments continue, these cities will be forced to pay interest rates far beyond the affordable level and far in excess of levels consistent with the risk of default.

Clearly, the uncertainties surrounding the threat of default have already had a profound impact on the entire municipal bond market and particularly on lower quality issuers. If New York City is allowed to default, it is probable that this deterioration will continue and perhaps increase significantly.

In the short run, a default can only lead to a temporary period of greater disorder in the municipal bond market. Testimony before the Committee suggests that this period of disorder may last as long as six months and will result from a continuation of already existing trends.

Banks, which up until recently were the backbone of the municipal market, would be forced to reexamine their positions in municipals and to further withdraw from certain portions of the market. Fiduciaries, trustees and underwriters would be forced to undertake similar steps. This would leave the individual investor as the only participant that conceivably could be expected to continue participation at existing levels. However, as testimony presented to the Committee suggests, the individual investor, who is often unsophisticated, is probably more
prone to panic and thus to reducing his or her participation in the market.

This short-term skepticism and disorder could have several disastrous effects. First and foremost, many credit-worthy, well-managed and financially sound cities with low credit ratings could be temporarily denied access to the credit markets. These cities may not be able to find any purchasers for their bonds and notes. If this were to occur, many of these cities which have legitimate short-term borrowing needs (for cash flow purposes or for capital construction) would be forced to default. In addition, all capital construction programs would have to be discontinued, further deepening the depression in the construction industry and causing further deterioration in basic infrastructure.

Second, even cities that were still able to market bonds and notes would be forced to pay much higher interest rates. This would cause many cities to devote a greater portion of their budgets to debt service payments, bringing about a concurrent reduction in other services essential to the health, safety and welfare of the residents of the city. Moreover, these higher interest payments will only exacerbate the fiscal problems of many cities that already are having difficulty balancing their budgets.

Finally, the borrowing problems of many State agencies cannot be ignored. Many of these agencies, particularly housing construction and finance agencies that are backed only by the moral obligation of their respective States, could be excluded from borrowing at any interest rate. This problem has already been manifest in Massachusetts and New York, and could become more common if New York City defaults. Even the housing agencies that could still borrow may be confronted with interest rates that are so high that they threaten the viability of essential housing construction programs. Such a development could deepen the recession in the construction industry and also undermine many Federal programs to improve the quality of housing available to moderate income American families.

In the long run, the consequences of default are much more difficult to predict. If it is probable that a New York City default, with its high visibility in the financial community, could cause many investors to withdraw from the market for several years. Rightly or wrongly, the risk associated with municipal bond investments would be perceived to be greater and the value of the pledge of "full faith and credit" would be significantly undermined. (Bankruptcy law changes that give city services first call on revenues before bond holders could also undermine the value of the "full faith and credit" pledge.) The increase in perceived risk would undoubtedly lead to higher interest rates and greater debt service payments and ultimately to tax increases and expenditure cutbacks sufficient to offset the increased debt service payments.

The impact of higher rates would be especially severe on cities with lower bond ratings. Most of these cities are well managed and credit-worthy. But in the wake of a New York City default, investors would demand higher yields on lower rated issues—those with A or Baa ratings. A list some of these cities is included under table 6.
In short, while no one can predict with perfect confidence the effect of default on the municipal bond market, it is safe to conclude that default would be a major event which would inevitably push interest rates higher and could cause temporary market access problems, thus precipitating further defaults.

Table 6.—Cities with an A or lower bond rating

<table>
<thead>
<tr>
<th>State</th>
<th>City</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>Mobile</td>
<td>BBB</td>
</tr>
<tr>
<td></td>
<td>Montgomery</td>
<td>A</td>
</tr>
<tr>
<td>Alaska</td>
<td>Anchorage</td>
<td>BBB-</td>
</tr>
<tr>
<td></td>
<td>Fairbanks</td>
<td>BBB</td>
</tr>
<tr>
<td>Arizona</td>
<td>Tucson</td>
<td>A+</td>
</tr>
<tr>
<td></td>
<td>Tempe</td>
<td>A+</td>
</tr>
<tr>
<td>Florida</td>
<td>Hollywood</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Miami</td>
<td>A+</td>
</tr>
<tr>
<td></td>
<td>St. Petersburg</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Tampa</td>
<td>A</td>
</tr>
<tr>
<td>Georgia</td>
<td>Macon</td>
<td>A+</td>
</tr>
<tr>
<td>Illinois</td>
<td>Decatur</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Chico</td>
<td>A</td>
</tr>
<tr>
<td>Indiana</td>
<td>Gary</td>
<td>BBB</td>
</tr>
<tr>
<td>Kentucky</td>
<td>Covington</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Lexington</td>
<td>A+</td>
</tr>
<tr>
<td></td>
<td>Louisville</td>
<td>A</td>
</tr>
<tr>
<td>Louisiana</td>
<td>Baton Rouge</td>
<td>BBB</td>
</tr>
<tr>
<td></td>
<td>Lafayette</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Lake Charles</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Monroe</td>
<td>BBB-</td>
</tr>
<tr>
<td></td>
<td>Shreveport</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>New Orleans</td>
<td>A</td>
</tr>
<tr>
<td>Maryland</td>
<td>Baltimore</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Rockville</td>
<td>A+</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>Boston</td>
<td>A</td>
</tr>
<tr>
<td>Michigan</td>
<td>Dearborn</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Detroit</td>
<td>A, 3ar</td>
</tr>
<tr>
<td></td>
<td>Livonia</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Warren</td>
<td>A+</td>
</tr>
<tr>
<td>Minnesota</td>
<td>Bloomington</td>
<td>A</td>
</tr>
<tr>
<td>Mississippi</td>
<td>Biloxi</td>
<td>BBB</td>
</tr>
<tr>
<td></td>
<td>Hattiesburg</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Jackson</td>
<td>A</td>
</tr>
<tr>
<td>Missouri</td>
<td>Jefferson City</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>St. Louis</td>
<td>A*</td>
</tr>
<tr>
<td>Montana</td>
<td>Missoula</td>
<td>BBB</td>
</tr>
<tr>
<td>Florida</td>
<td>Albany</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Buffalo</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>New York City</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Niagara Falls</td>
<td>A</td>
</tr>
<tr>
<td>North Carolina</td>
<td>Asheville</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Fayetteville</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Gastonia</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Wilmington</td>
<td>A</td>
</tr>
<tr>
<td>North Dakota</td>
<td>Minot</td>
<td>A+</td>
</tr>
<tr>
<td>Ohio</td>
<td>Cleveland</td>
<td>A*</td>
</tr>
<tr>
<td></td>
<td>Youngstown</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Canton</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Springfield</td>
<td>A</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>Philadelphia</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Erie</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Harrisburg</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Altoona</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Wilkes-Barre</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Chester</td>
<td>BBB</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>Providence</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Woonsocket</td>
<td>A</td>
</tr>
<tr>
<td>South Carolina</td>
<td>Greenville</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Spartanburg</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Rock Hill</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>South Dakota: Aberdeen</td>
<td>A+</td>
</tr>
<tr>
<td>Tennessee</td>
<td>Knoxville</td>
<td>A+</td>
</tr>
<tr>
<td>Virginia</td>
<td>Virginia Beach</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Hampton</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Chesapeake</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Washington</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Spokane</td>
<td>A</td>
</tr>
<tr>
<td></td>
<td>Tacoma</td>
<td>A</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>West Allis</td>
<td>A+</td>
</tr>
<tr>
<td></td>
<td>Sheridan</td>
<td>A</td>
</tr>
</tbody>
</table>

* Rating suspended.
D. ON THE BANKING SYSTEM

The Committee received testimony regarding the probable impact of default upon the banking system from Frank White, Chairman of the Federal Deposit Insurance Corporation, who testified concerning State non-member banks; James E. Smith, Comptroller of the Currency, who testified concerning national banks; and George W. Mitchell, Vice Chairman of the Board of Governors of the Federal Reserve System, who testified concerning State member banks. Although the agencies made somewhat different assumptions in their surveys of the three sets of banks, some general points emerge from their testimony which illuminate the effects of default on the banking system.

A New York City default would seriously impair the capital position of a number of banks throughout the country, although relatively few would be threatened with insolvency. Banks are heavy investors in the municipal bond market, holding almost 50 percent of the outstanding securities, and thus they are particularly vulnerable to disruptions in that market. Since banks have to hold enough assets and capital to cover their liabilities, if the value of an asset declines, then they have to find some way to rebuild their capital position. Default will result in an immediate reduction in the market value of outstanding New York City securities. Under current practices, the bank regulatory agencies permit banks to carry assets at book value, i.e., value at maturity even though they may be selling at a lower value on the market. However, in the case of a default, the agencies require the banks to write down the defaulted securities to market value over a period of six months, because full payment at maturity is then placed in doubt. These write-downs will reduce the capital positions of banks that are large holders of New York City securities, to the point of insolvency in some cases.

Witnesses from the bank regulatory agencies did not foresee a wave of bank failures around the country in the aftermath of a New York City default. However, they did indicate that a substantial number of banks would suffer serious impairment of capital, at least in the short run, and some bank failures are likely to occur, especially if New York State defaults as well. Their estimates of the maximum number of bank failures possible if the City defaults add up to 35 banks while 69 banks could fail if New York State defaults along with the City.

The banks in danger of failing are predominantly smaller institutions scattered throughout the country; only a few are in New York State. The agencies refused to give the names of individual banks, for fear of chasing off runs on those banks. The numbers are small enough that the entire banking system would not be shaken, but the effect could be devastating on a number of towns and cities throughout the country.

The latest FDIC survey reveals that there are a total of 283 non-member State banks in 10 States (including Puerto Rico) which currently hold more than 20 percent of their net worth in New York State, New York State agency, and New York City obligations. A list of these States and the banks in each category is shown in Table 7. Forty-five of these banks have over 70 percent of their net worth in
these securities. Ten States have ten or more banks in that situation: Alabama, Arkansas, Florida, Illinois, Louisiana, Mississippi, Missouri, New York, Tennessee and Texas.

<table>
<thead>
<tr>
<th>State</th>
<th>20 to 30 percent</th>
<th>50 to 70 percent</th>
<th>Over 70 percent</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>17</td>
<td>1</td>
<td>1</td>
<td>19</td>
</tr>
<tr>
<td>Alaska</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Arkansas</td>
<td>16</td>
<td>6</td>
<td>3</td>
<td>25</td>
</tr>
<tr>
<td>California</td>
<td>3</td>
<td></td>
<td></td>
<td>3</td>
</tr>
<tr>
<td>Colorado</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Connecticut</td>
<td></td>
<td>2</td>
<td></td>
<td>2</td>
</tr>
<tr>
<td>Delaware</td>
<td></td>
<td>2</td>
<td></td>
<td>2</td>
</tr>
<tr>
<td>District of Columbia</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Florida</td>
<td>27</td>
<td>2</td>
<td>5</td>
<td>34</td>
</tr>
<tr>
<td>Georgia</td>
<td>2</td>
<td>1</td>
<td></td>
<td>3</td>
</tr>
<tr>
<td>Hawaii</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Idaho</td>
<td>1</td>
<td>1</td>
<td></td>
<td>2</td>
</tr>
<tr>
<td>Illinois</td>
<td>12</td>
<td>2</td>
<td>1</td>
<td>15</td>
</tr>
<tr>
<td>Indiana</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Iowa</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kansas</td>
<td></td>
<td>1</td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Kentucky</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Louisiana</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maine</td>
<td></td>
<td>1</td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Maryland</td>
<td>1</td>
<td></td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Massachusetts</td>
<td></td>
<td>1</td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Michigan</td>
<td>1</td>
<td>1</td>
<td></td>
<td>2</td>
</tr>
<tr>
<td>Minnesota</td>
<td>1</td>
<td>1</td>
<td></td>
<td>2</td>
</tr>
<tr>
<td>Mississippi</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Missouri</td>
<td>18</td>
<td>5</td>
<td>3</td>
<td>26</td>
</tr>
<tr>
<td>Montana</td>
<td>5</td>
<td></td>
<td></td>
<td>5</td>
</tr>
<tr>
<td>Nebraska</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nevada</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Hampshire</td>
<td></td>
<td>1</td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>New Jersey</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Mexico</td>
<td>1</td>
<td></td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>New York</td>
<td>10</td>
<td>3</td>
<td>3</td>
<td>16</td>
</tr>
<tr>
<td>North Carolina</td>
<td></td>
<td>1</td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>North Dakota</td>
<td>1</td>
<td></td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Ohio</td>
<td>3</td>
<td>3</td>
<td></td>
<td>6</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>2</td>
<td></td>
<td></td>
<td>2</td>
</tr>
<tr>
<td>Oregon</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pennsylvania</td>
<td></td>
<td>3</td>
<td></td>
<td>3</td>
</tr>
<tr>
<td>Rhode Island</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>South Carolina</td>
<td></td>
<td>1</td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>South Dakota</td>
<td></td>
<td>3</td>
<td></td>
<td>3</td>
</tr>
<tr>
<td>Tennessee</td>
<td>22</td>
<td>1</td>
<td>2</td>
<td>25</td>
</tr>
<tr>
<td>Texas</td>
<td>18</td>
<td>1</td>
<td>2</td>
<td>21</td>
</tr>
<tr>
<td>Utah</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vermont</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Virginia</td>
<td></td>
<td>2</td>
<td></td>
<td>2</td>
</tr>
<tr>
<td>Washington</td>
<td></td>
<td>1</td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>West Virginia</td>
<td></td>
<td>1</td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Wisconsin</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wyoming</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other areas</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Guam</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Puerto Rico</td>
<td>1</td>
<td></td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Virgin Islands</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>225</strong></td>
<td><strong>40</strong></td>
<td><strong>23</strong></td>
<td><strong>288</strong></td>
</tr>
</tbody>
</table>

It appears that the banking system as a whole could probably absorb the impact of a New York default without major disruption. The Chairman of the Federal Reserve Board has indicated that the Fed will lend unlimited funds through the discount window to any member or nonmember bank with temporary liquidity problems. The FDIC can assist insured banks that require temporary infusions of

S. Rept. 94-115 — 4
new capital. And all the agencies will allow banks to suspend the write-down of defaulted assets for six months. These actions should minimize the shock of default.

The fact that the banking system can absorb the shock of default does not imply that banking practices will not be affected by a default. The longer term implications are troubling. Banks have already been retrenching due to the problems they have run into as a result of the recession. Many banks, particularly clearinghouse banks in New York, are already suffering capital impairment due to REIT loan losses, the W.T. Grant bankruptcy, and other delinquent corporate loans. A default by New York City, and perhaps the State and its agencies as well, on top of these other loan losses, will only serve to make bank lending practices still more conservative than they are already.

Banks are likely to make fewer new loans, as they work to rebuild capital. They will tend to charge higher interest rates on the loans they do make in order to increase their returns. Some borrowers will pay the price and pass on the increased cost to the consumer; others will be pushed out of the credit market. These practices will make it harder for businesses to obtain credit, especially new ventures and companies in trouble which could be salvaged. Employment would rise more slowly. All of these developments would hamper the progress of economic recovery.

Nearly all banks will suffer some temporary loss of liquidity should New York City default. The defaulted securities will be totally illiquid. The secondary market for all municipal bonds would close for some length of time, and thus the banks would not be able to unload these bonds to relieve their liquidity problems. A default by New York City and its agencies would greatly increase the liquidity strains. These developments will also lead to higher interest rates and reduced lending, as the banks move to rescue and preserve their liquidity situation.

A number of other problems for the banking system could arise as offshoots of a New York City default. Investors in large, uninsured certificates of deposit may well shy away from depositing their funds in certain banks seen as vulnerable on account of default and this could lead at least temporarily to a large outflow of deposits, particularly from New York City banks. A similar trend could develop internationally, with Eurodollar and other foreign currency deposits being shifted from foreign branches of U.S. banks with large holdings of New York securities to foreign branches of other U.S. banks or to other international banks. These developments could exacerbate the liquidity strains on individual banks, at least in the short term.

The money supply also could be affected by default. If the Federal Reserve has to supply large amounts of funds through the discount window to relieve banks’ liquidity problems, there could be a temporary bulge in the money supply which would be difficult to offset through open market operations. And if the Fed cannot contain the impact, this development could provoke inflation and higher interest rates.

In summary, a default by New York City is not likely to cause any major disruption of the banking system. However, it could well
result in higher interest rates, reduced bank lending activity, and temporary liquidity strains. All of these factors could slow down the progress toward economic recovery.

II. ON THE ECONOMY

It is impossible to predict with accuracy the impact of a New York City default on the economy. Economists are almost equally divided on the subject. Some foresee a substantial effect on employment and economic growth. Others see little or no danger. Estimates as to how much GNP may be reduced as a result of a New York City default range from zero to $20 billion. No one can be sure what will actually happen. Nonetheless, there is a serious risk to the economy that must be taken into account by the Congress in its decision on the New York City fiscal crisis.

A default by New York City could impact the economy in two major ways. First, state and local spending, which comprises 14% of GNP, could be reduced. Second, banks and other lenders could contract their volume of lending.

The impact of a default on state and local spending could operate in a variety of ways. Higher interest rates in the municipal bond market could encourage some state and local governments to postpone capital projects. Interest rate ceilings in many states may cause other governments to cut back on their capital spending even if they were willing to pay higher rates. Thirty-eight states have interest rate ceilings on municipal borrowing and most of these are set at 7 or 8 percent. With interest rates in the municipal bond market already approaching these levels, any further increase in market rates precipitated by a New York City default could cause substantial cutbacks in capital borrowing.

Also, many state governments have attempted to make up for their revenue shortfall by the recession by borrowing in the short-term market. If New York City defaults, the short-term market could be temporarily closed to some municipal borrowers and others would be required to pay sharply higher rates. These developments will cause cuts in operating budgets, reductions in state and local payrolls and higher unemployment.

A second major impact on the economy could arise from a contraction of credit by commercial banks. New York City and MAC have outstanding obligations of over $14 billion. Many of these bonds and notes are held by commercial banks. Under present regulations, banks are permitted to carry municipal securities at book rather than market value. However, if the city defaults on its obligations, these banks would eventually be forced to write down the value of their New York City securities to the current market value. This write down could substantially reduce bank capital and impair the ability of banks to carry on their normal lending activities. The Chairman of the Federal Reserve Board has warned several times that the economic recovery could be impeded unless the banking system was able to attract additional capital.

There have been several attempts to quantify the economic impact of a New York City default. All of these must be viewed with caution.
because they depend critically on the assumptions made. Nonetheless, these studies do give some idea of the range of possible results flowing from a New York City default.

One study prepared by the Senate Budget Committee by Professors F. Gerard Adams and James M. Savitt estimates that a New York City default could increase municipal bond rates by 100 basis points (one percentage point). The authors estimate that this increase in municipal bond interest rates would lead to a cut-back of $3.0 billion in State and local spending in 1976 and $6 billion in 1977. On these assumptions, they predict a GNP loss of $1.8 billion in 1976 and $10 billion by mid-1977, and a rise in unemployment of 300,000 by that date.

Otto Eckstein presented a similar estimate to the House Banking Committee. Eckstein predicted an $8 billion loss in GNP by mid-1977 and an increase in unemployment of 300,000.

A third study prepared by the JEC staff estimates that there could be a loss of $18 billion in GNP by the 4th quarter of 1976 and an increase in unemployment of 300,000. The JEC study also estimates Federal tax revenues would decline by $1 billion because of the reduction in economic activity.

VI. POLICY OPTIONS CONSIDERED BY THE COMMITTEE

The Committee considered three policy options available to the Congress for dealing with the New York City fiscal crisis. The first option was to enact Federal loan guarantee legislation for the purpose of preventing a New York City default. The second option was to enact standby legislation providing for emergency credit assistance to the City to enable it to continue essential services after a default. The third option was to enact no credit assistance legislation at this time while relying on amending the Federal Bankruptcy Act to facilitate the use of that Act by the City. This section of the report will discuss these options in greater detail and indicate how the Committee arrived at its recommendations to the Senate of the first option, a Federal guarantee to prevent default.

OPTION THREE: THE BANKRUPTCY APPROACH

The third option described above is essentially the program recommended by the President. It would rely exclusively on amending the Federal Bankruptcy Act to make it feasible for the City to file for bankruptcy in Federal Court.

There is a widespread consensus that the present provisions of the Bankruptcy Act contained under Chapter Nine make it impossible for large cities to apply for bankruptcy. These provisions require that creditors holding 31% of the city's debt must first agree to a restructuring plan before the city can petition the court.

After that, creditors representing two-thirds of the city's debt must agree to any final plan. Considering the fact that most of New York City's obligations are held in bearer form by more than 160,000 bond and note holders, it would be a formidable task to even locate these creditors, let alone obtain their timely approval of a plan for restructuring the City's debt. The amendments to the Bankruptcy Act pro-
posed by the President would permit large cities to file a bankruptcy petition without prior agreement of 51% of their creditors and would require that only two-thirds of those creditors actually voting approve the final restructuring plan.

There may be certain advantages to bankruptcy as a solution to New York City's problems. The City could stretch out its short-term debt by convincing the holders of maturing notes to accept long-term City bonds at lower interest rates. Debts service payments towards principle or interest or both could be postponed. Interest rates on outstanding obligations could be reduced. The amount owing on existing bonds or notes could be written down. Onerous or burdensome wage and pension contracts might be able to be rewritten. All of these actions would reduce the financial burden on the City until it brought its budget into balance and restored investor confidence.

While the bankruptcy route may enable the City to get out of paying some of its bills, at least temporarily, it would not solve all of the City's short-term financing problems. Even if all debt service payments towards principal and interest were suspended (which may be difficult to achieve), the City would still be short $1.3 billion from December 1, 1975 through March 31, 1976 due to the seasonal imbalance between its revenues and expenditures.

Under normal circumstances, this temporary cash deficit would be offset by an estimated revenue surplus of more than $1 billion in the last quarter of the City's fiscal year. However, the fact of bankruptcy would drastically alter the City's financial position. City officials estimate tax revenues would decline by $500 million during that period. Some of the City's creditors might well seek to cover their losses by withholding their tax payments.

In addition, it is questionable that payments on the MAC debt could be postponed since the revenues to service that debt are segregated and are controlled by the State, which is also a major holder of MAC paper. The inability to suspend payments on MAC debt would increase the City's cash deficit by another $500 million.

It is also likely that the City would continue interest payments on its outstanding debt, especially if it had hopes of ever re-entering the capital market. This would raise the City's cash needs by another $500 million.

Finally, it is doubtful that the State of New York would go ahead with its plan to advance the City $800 million in aid payments in April if the City is in default. Thus, the net cash deficit could total $2.5 billion for the balance of fiscal year 1976 even if the City goes into bankruptcy. At the very least the City would have to finance a deficit of $1.8 billion over 4 months and most likely would be required to finance a deficit of $2.5 billion over seven months.

In theory, it is possible for a bankrupt firm or city to borrow. The amendments to the Bankruptcy Act proposed by the President would enable the bankruptcy referee to authorize a city to issue debt certificates to meet its cash needs while in bankruptcy. These certificates would be secured by claim on the City's revenues ahead of all obligations issued before bankruptcy. Presumably this prior claim on revenues is intended to make the certificates marketable with the investing public. However, given the size of New York City's short-
term needs—between $1.2 and $2.5 billion—it is extremely doubtful that the certificates could be sold without some kind of Federal assistance. Similar certificates authorized by the trustees of the Penn Central in the amount of only $125 million were not sold until a Federal guarantee was provided.

If the investing public did not buy the new certificates authorized by a bankruptcy court, the City would be in serious trouble. Its cash deficit of $1.2 billion just for the four months period after December 1 is more than 50% of the controllable items in its operating budget. Without access to credit, the City would have to lay off policemen and firemen, sanitation workers, and teachers. It would have to close many of its schools, shut down day care centers, and cut back on hospital services. In short, the City would be brought to a screeching halt at an incalculable social cost.

Because of these financing problems, the Committee was unanimous in its conclusion that a simple amendment to the Federal Bankruptcy Act is not by itself a viable solution to the New York City fiscal crisis. Some form of Federal assistance will be required whether or not New York City is able to file for bankruptcy. The real issue is whether that assistance is to be provided before default or after default.

**OPTION TWO: AID AFTER DEFAULT**

The Committee gave careful consideration to a second option of providing Federal credit assistance to New York City after default. The specific proposal given the most consideration would have provided up to $3 billion in one-year guarantees to allow the City to continue services essential to the health, safety or welfare of its residents. This proposal would supplement the amendments to the Bankruptcy Act by making it possible for the Federal government to guarantee the debt certificates authorized by a bankruptcy referee. Such an approach would enable the City to obtain some of the long run advantages of bankruptcy while providing a stand-by mechanism for financing its short term credit needs.

The Committee rejected Option Two by a vote of 7-6. The Committee based its rejection of this option on the following considerations:

First, the Committee believes that more Federal aid over a longer period of time will be required if New York City is permitted to go into default and bankruptcy. The City's tax revenues will decline for the reasons already indicated. State aid will be reduced as the State struggles to preserve its own solvency in the wake of New York City default. Jobs and payrolls will be lost as business firms decide to locate elsewhere.

Most importantly, the fact of bankruptcy will impair the ability of the City to re-enter the credit market for years. (It took Detroit eight years to re-enter the capital market after it defaulted in 1933.) There are legal restrictions in thirty states which prevent fiduciaries and other financial institutions from investing in the bonds of a city that has defaulted. In addition, it will take at least several years to dispose of all of the complex litigation pursuant to a bankruptcy, during which time the City's securities will be unmarketable.

The Committee staff has estimated that after default, New York City is likely to need Federal loan guarantees of $2.5 billion by the
end of fiscal year 1976. Moreover, because of the loss of tax revenues and State aid and the inability of the City to re-enter the capital markets, the staff estimates the City will require Federal guarantees of $5 billion by the end of fiscal year 1980, even if it makes no payments toward principal on its debt service account and brings its operating budget into balance in accordance with its three year financial plan. With the City still in bankruptcy at the end of this period and $5 billion in short-term federally guaranteed obligations on its books, there is little hope that it will be able to re-enter the private capital market. A default carries with it the probability that the City will be on the Federal doorstep for years to come.

A second reason for avoiding a New York City bankruptcy is to prevent an economic ripple effect from engulfing the municipal bond market and the economy at large. As discussed elsewhere in this report, no one can be certain about the exact dimensions of the ripple effect or whether the market has already discounted a New York City default. Nonetheless, the potential effect of a default by the nation’s largest city is so serious that the Committee believes the Congress cannot afford to take the chance of permitting a default to occur. The cost of a New York City default to the Federal government and to State and local taxpayers across the country could well be enormous.

Third, the Committee believes a New York City default coupled with the changes in the Federal Bankruptcy Act proposed by President Ford could encourage other cities to mismanage their fiscal affairs. By making it far easier to file for bankruptcy, the proposed revisions to the Bankruptcy Act offer other cities an easy way to avoid paying their bills. Some city officials may be more inclined to give into unreasonable wage demands or to avoid tough economic decisions if they know they can always be bailed out by a bankruptcy judge.

To be sure, some revision of municipal bankruptcy procedures may be needed anyway. But if a city the size of New York is the first to use these new procedures, a dramatic and highly visible precedent will be established for every other mayor and city council in the country. Instead of encouraging sound fiscal management, a New York City bankruptcy can have exactly the opposite effect. Moreover, the point will not be lost on municipal bond investors who will understandably wonder just how secure their investments really are if a city can get into bankruptcy court at the drop of a hat. It may be only coincidental that one day after the President’s announcement of his proposal to amend the Bankruptcy Act, the city of Chicago (with an AA bond rating) was forced to withdraw a $36 million bond issue.

Fourth, the Committee does not accept the President’s argument that only a bankruptcy judge can pressure the City into cutting back on wasteful spending and balancing its budget. The City already has been placed in a virtual receivership. Its fiscal affairs are under the firm control of the Emergency Financial Control Board chaired by the Governor. Five of the seven members are state officials or appointees and include three able representatives of the business and financial community.

The State Emergency Financial Control Board has already approved a plan for bringing the City’s budget into balance in just 29 months. This plan, after allowing for inflation and uncontrollable items, will require a real spending cut of over 20% in the controllable
portion of the City's budget. The Committee does not believe a faster

There is no reason for assuming a bankruptcy judge could do a
time table can be imposed on the City without seriously jeopardizing
better job of supervising the City than the Governor of the State of
the welfare of its 8 million residents.
New York and the other members of The Emergency Financial

There is no reason for assuming a bankruptcy judge could do a
Control Board. These individuals have placed their political and profes-
time table can be imposed on the City without seriously jeopardizing
sional reputations on the line and have every incentive to do their best.
the welfare of its 8 million residents.

A bankruptcy judge operates under a wholly different set of restric-
tions and limited powers. He would be more concerned with legal

The existence of a bankruptcy judge would, to some extent, take the Gov-
questions such as fairness to different classes of creditors. Moreover,
ernor and The Emergency Financial Control Board off the hook. Any
the Committee does not believe that a bankruptcy judge could do a better job
failure to achieve the necessary fiscal reforms could be blamed on the
over the next three years. His ability to make fundamental reforms would be limited. He
Federal bankruptcy judge rather than on State officials.
would not have the capacity to make the day-to-day decisions required in

The Emergency Financial Control Board already has a good track
running a city. Moreover, the installation of another supervisor over
record for imposing economies on the City. The Committee does not
the City's fiscal affairs might well be counter-productive.
believe that a bankruptcy judge could do a better job over the next three
years. His ability to make fundamental reforms would be limited. He

**OPTION ONE: PREVENT DEFAULT**

After reviewing all the evidence and hearing all the arguments, the
Committee has concluded that bankruptcy is not a viable solution for
the City or the nation. The Committee has therefore recommended a
bill that is designed to prevent a bankruptcy by our largest city. The
Committee does so not because it believes New York City is especially
deserving— it is not; and not because we condone the fiscal policies fol-
lowed by the City over the last ten years— we do not. Instead, the Com-
mitee believes the Congress and the nation have no other choice. The
potential cost of a New York City default far exceeds the amount of
guarantee assistance provided in the bill.

As a practical matter, the bill reported by the Committee will not
cost the Federal government a single penny. The loan guarantees au-
authorized would be fully secured by revenue sharing payments and tax
revenues of the City and the State. The guarantee fee of 3½ percent
will earn the Federal government over $400 million over the life of
the program.

The Committee also believes the bill it has reported is in no way a
"bail out" of New York City. It imposes all of the tough and stringent
conditions recommended by the Secretary of the Treasury and the
Chairman of the Federal Reserve Board. In fact, the conditions are
so onerous that there is little danger the legislation will invite similar
requests for aid from other cities. How many mayors would be willing
to surrender all of their fiscal powers to the governor of their State in
order to obtain a Federal loan guarantee? How many States would be
willing to raise their taxes in order to qualify one of its cities for a loan
guarantee? How many cities would be willing to pay an extra 3½
percent guarantee fee on their bonds? How many cities would submit
to a 20 percent reduction in controllable spending? How many cities would be willing to have a three-man Federal Board headed by the Secretary of the Treasury directing their fiscal affairs?

If the only object of forcing a New York City bankruptcy is to teach it and the rest of the country a lesson, the Committee believes the lesson has already been well learned. The sorry spectacle of the nation's largest city struggling to avoid default has been front page news for months. By now, the message should be painfully clear to everyone. Governments simply cannot go on spending money they don't have. After all the agonizing attention given to New York City's problems, the Committee cannot conceive that other cities would be tempted to follow New York City's path if the stringent loan guarantee bill before the Senate is approved.

In addition to imposing tough conditions on the City and State, the bill reported by the Committee also makes the private investment community bear a substantial share of the burden. The bill requires that holders of 65 percent of MAC securities must agree to exchange them for non-guaranteed long-term bonds at lower rates of interest. This requirement would restructure $2.2 billion of MAC's debt and help reduce the debt service burden on the city. Most of the burden of the restructuring would fall upon the large New York City banks and city pension funds, who aided and abetted the City's plunge into fiscal delinquency.

The bill also requires that the holders of 49 percent of the City's debt maturing prior to June 30, 1976, must agree to accept non-guaranteed long-term city bonds at a relatively low rate of interest. This requirement will reduce the amount of Federal guarantee assistance needed by $1.2 billion and enable the City to avoid the problem of constant borrowing to roll over its short term debt.

The bill also establishes a definite timetable for phasing out Federal guarantees and increasing the participation of the private market in meeting the City's borrowing needs. Under the legislation, the total amount of guarantees outstanding would be limited to $4 billion through June 30, 1977; $3.5 billion through June 30, 1978; $2.5 billion through June 30, 1979; $1.5 billion through June 30, 1980; and zero thereafter. It is a tight but realistic schedule for phasing out Federal assistance.

Finally, the bill contains a standby program for meeting the emergency credit needs of the City in the event that all of the stringent conditions cannot be met and the City defaults. The standby program under section 6 of the bill authorizes loan guarantees of up to $600 million to enable the City to continue services essential to health, safety and welfare. The term of the guarantee could not exceed three months and the authority to make the guarantees would expire on March 31, 1976.

The standby program under section 6 is intended as only a temporary device for helping the City to meet its essential needs in the period immediately following a default. During this time, Congress would have to consider and act upon a longer range program for helping the City to meet its borrowing needs. As indicated elsewhere in this report, the Committee believes the requirements for Federal aid after default will exceed the amount authorized and will continue far beyond the expiration of the legislation reported by the Committee.
The legislation further provides that if the obligations guaranteed under the bill are made taxable through subsequent legislation, the guarantee fee ceiling would be reduced to one percent. The Committee believes that these obligations should be taxable in order to avoid giving New York City a preferred position in the market for tax-exempt securities. Moreover, since the rate on taxable securities will be substantially higher than the rate on equivalent tax-exempt securities, a requirement that the New York City guaranteed securities be taxable will discourage other cities from requesting similar assistance from the Federal government. Finally, the U.S. Treasury will earn additional tax revenues on taxable New York City bonds and these additional revenues will provide further security to the Federal government’s exposure under the guarantee program.

For all of the foregoing reasons, the Committee recommends that the Congress enact subsequent tax legislation making the guaranteed New York State securities taxable. In the meantime, the Committee believes that the maximum guarantee fee of 3 1/4 percent provided for in the bill will give the Federal Board the flexibility to set the rate paid by the city at a level equivalent to a taxable issue. In order to avoid the problem of having guaranteed, tax-exempt securities adversely impacting the municipal bond market, the bill further provides that until these securities are made taxable, they must be purchased by the Federal Financing Bank, an agency under the control of the Secretary of the Treasury. This will remove these securities from the tax-exempt market and thus make it easier for other State and local governments to borrow at reasonable rates.

COST OF THE LEGISLATION

In compliance with Sec. 252(a) (1) of the Legislative Reorganization Act of 1970, as amended (3 U.S.C. 1901), the Committee estimates there will be no cost to the Federal Government in carrying out the provisions of the legislation. Any administrative expenses involved in carrying out the legislation would be paid from the guarantee fee authorized under sections 3 and 6. The Committee knows of no estimate of a Federal agency indicating any cost of carrying out the legislation.

VII. SECTION-BY-SECTION ANALYSIS OF THE BILL

SHORT TITLE AND STATEMENT OF PURPOSE

Section 1(a) cites the title of the Act as the “Voluntary Municipal Reorganization Act of 1975.”

Section 1(b) states that Congress finds it is in the national interest to prevent the default by State and local governments on their outstanding obligations in a manner consistent with sound fiscal reform, and to establish a temporary program of emergency credit assistance to State or local governments unable to avoid default by the means provided in the Act.

DEFINITIONS

Section 2 defines for purposes of the Act the terms “Board,” “applicant,” “assisted municipality,” “State,” and “Governor.”
ESTABLISHMENT OF THE BOARD

Section 3 establishes a Voluntary Municipal Reorganization Board, composed of the Secretary of the Treasury, as Chairman, the Chairman of the Board of Governors of the Federal Reserve System, and the Secretary of Labor, and provides that the decisions of the Board shall be by majority vote.

AUTHORITY OF THE BOARD

Section 4(1) authorizes the Board, on such terms and conditions as it deems appropriate, to guarantee or make commitments to guarantee obligations issued by a State, State agency or unit of local government in order to prevent a default and carry out fiscal reform under the provisions of the Act.

Section 4(2) authorizes the Board, in the event of a default, to act to maintain essential services by providing emergency guarantees of the obligations of the municipality, or of its trustee or receiver. The guaranteed obligations shall be secured by a first lien on the municipality's future revenues.

STANDARDS AND CONDITIONS FOR GUARANTEES TO PREVENT DEFault

Section 5(a) sets a number of conditions which the applicant for assistance under the Act must meet in order to receive the Federal guarantee. It also requires investors in the private sector to bear part of the risk and participate in a voluntary restructuring of the municipality’s debt, by agreeing to exchange a certain percentage of the notes they now hold for unguaranteed serial obligations issued by the municipality bearing longer maturities (at least five years) and lower interest rates. Furthermore, the amount of private participation must increase over time, as the Federal guarantee assistance is phased out.

Although the provisions of this section are stated in general terms, they basically describe the steps that New York City and New York State have taken to date or have indicated they are willing to take in order to obtain a Federal guarantee. While other municipalities along with their States are not technically barred from qualifying in the event of a financial emergency, the very stringent nature of the conditions set should be an effective deterrent to others following in New York’s path. The specific provisions are as follows:

Section 5(a)(1) requires a finding by the Board that the obligations to be guaranteed will be issued by a State or State agency in order to finance the credit needs of a municipality under its jurisdiction, that neither the State nor the municipality can obtain credit elsewhere in the private market, and that failure to obtain such credit is likely to cause the municipality, State or agency to default on its outstanding obligations. A State or City’s inability to obtain credit in the private market is intended to include those situations where credit might be available but only on terms which are likely to further impair the ability of the State or municipality to avoid default.

Section 5(a)(2) requires the municipality to submit a financial plan, approved by the Governor and in accordance with accounting principles prescribed by the Board, which the Board believes will bring
the municipality's budget (including operating expenses and debt service) into balance with its revenues by the second full fiscal year following the initial application for assistance. The financial plan must provide for reduction in the cost of employee pension plans and for the minimum feasible participation by the pension funds in supplying the credit needs of the municipality. The financial plan may be revised from time to time with the approval of the Board.

Section 5(a)(3) requires the State to demonstrate that it has the authority to control the fiscal affairs of the municipality for the entire period during which the loan guarantee will be outstanding. This must include the authority to determine all revenue estimates, set aggregate expenditure limits, disapprove all expenditures not in compliance with the financial plan, approve all borrowing, and authorize all contracts during that period.

Section 5(a)(4) requires the State or agency give satisfactory assurances to the Board that it will repay any losses the Federal Government may sustain from guarantees furnished under this section. The State and municipality must pledge as security against such losses the payments they are entitled to receive under general revenue sharing or any other comparable general purpose financial assistance program of the Federal Government.

Section 5(a)(5) provides that the municipality must agree (i) to make available to the Board, the Comptroller General of the United States, and any certified public accountant designated by the Board, all its accounts, books, records, documents or other information which the Board may request bearing on its financial situation prior to and during the period of the Federal guarantee; (ii) to follow generally accepted accounting principles as prescribed by the Board; and (iii) to provide periodic reports as required by the Board.

Section 5(a)(6) provides that the State or agency must pay to the Board a guarantee fee of not more than 3/10 percent on the obligations guaranteed. If Congress passes legislation subsequently to require that the obligations be taxable rather than tax-exempt, then the guarantee fee will drop down to one percent.

Section 5(a)(7) requires the State to agree to provide a grant to the municipality for each of its fiscal years during which the guarantee is outstanding. The grant must conform to the following terms: (A) be equal to at least one-half of the municipality's anticipated operating deficit for the relevant fiscal year or portion thereof; (B) be derived from the general tax revenues of the State; (C) be in addition to all other grant or similar assistance provided by the State to the municipality prior to its initial request for a Federal guarantee; (D) be provided at such times as the Board may prescribe; and (E) be used by the municipality to meet its operating expenses in accordance with the approved financial plan.

Section 5(a)(8) provides for a restructuring of the municipality's debt into longer-term, lower interest rate obligations in order to reduce the financial burden on the municipality and enable it to meet all its credit needs without Federal guarantee assistance at the earliest possible time. The restructuring shall be accomplished through voluntary agreements by the holders of the municipality's obligations to exchange those obligations under the following terms: (A) the
holders of at least 65 percent of the bonds issued by a State agency on behalf of the municipality (i.e., MAC bonds) shall exchange them for bonds issued by that agency with serial maturities of not less than five years and interest rates as determined by the Board (except that no such bond can have an earlier maturity than the obligation exchanged); and (B) the holders of at least 40 percent of the municipality's bonds maturing prior to June 30, 1976, shall exchange them for serial bonds issued by the municipality with maturities of not less than five years and interest rates as determined by the Board.

Section 5(b) sets further conditions for the exercise of the Board's guarantee authority.

Section 5(b)(1) limits the maturity of any obligations guaranteed to one year.

Section 5(b)(2) sets the conditions for phasing out Federal guarantee assistance over time by limiting the amount of guaranteed obligations outstanding at any time to $1 billion through June 30, 1977, $2.5 billion through June 30, 1978, $2.5 billion through June 30, 1979, $1.5 billion through June 30, 1989, and zero thereafter.

Section 5(b)(3) prohibits the Board from guaranteeing any obligations at any time when it determines that the State or agency or the municipality is not meeting its obligations under this section or is not adhering to the schedule required under the financial plan.

Section 5(b)(4) provides that the Board, in approving guarantees subsequent to June 30, 1976, shall require maximum feasible participation by investors in the private sector in purchasing unguaranteed obligations issued by the municipality with serial maturities of not less than five years. The purpose of this is to further promote the phasing out of the Federal guarantee at the earliest possible date, and in no event later than the statutory expiration date of June 30, 1979.

STANDARDS AND CONDITIONS FOR GUARANTOR OF OBLIGATIONS OF ISSUERS IN DEFAULT

Section 6 authorized the Board to provide emergency assistance to a municipality in order to maintain essential services in the event of a default or bankruptcy, by guaranteeing obligations issued by the municipality or a representative acting in its behalf. It sets conditions for receipt of a guarantee under this section, similar to those required under section 5.

Section 6(a)(1) provides that the Board must make the following findings: (A) that assistance cannot be provided under section 5 because of a failure to meet the requirements of that section; (B) that the municipality has either defaulted on its outstanding obligations or filed a petition under the Bankruptcy Act; (C) that it is unable to obtain credit in the private market; and (D) that a guarantee is necessary to permit the maintenance of essential services or programs the interruption of which would endanger the health, safety or welfare of the residents of the affected area.

Section 6(a)(2) requires the municipality or other issuer of obligations guaranteed under this section to submit a financial plan for achieving a balanced budget, in accordance with accounting principles prescribed by the Board.
Section 6(a) (3) requires the issuer to provide satisfactory assurances that it will repay any losses sustained by the Federal Government as a result of guarantees furnished under this section. The municipality must pledge as security against such losses the payments it is entitled to receive under general revenue sharing or any other comparable general purpose financial assistance program of the Federal Government.

Section 6(a) (4) provides that the issuer must agree (i) to make available to the Board, the Comptroller General of the United States, and any certified public accountant designated by the Board all its accounts, books, records, documents or other information which the Board may request bearing on its financial situation prior to and during the period of the Federal guarantee; (ii) to follow generally accepted accounting principles as prescribed by the Board; and (iii) to provide periodic reports as required by the Board.

Section 6(a) (5) provides that the issuer must pay to the Board a guarantee fee of not more than 3 1/2 percent on the obligations guaranteed. If Congress passes legislation subsequently to require that the obligations be taxable rather than tax-exempt, then the guarantee fee will drop down to one percent.

Section 6(a) (6) provides that in the case of an issuer which is a unit of local government, the State in which it located must agree to give a grant out of general tax revenues equal to one-half of the anticipated operating deficit for its fiscal year or portion thereof during which time the Federal guarantee is outstanding. The grant must be given at such times as the Board may prescribe and in accordance with the accounting principles it lays out, and the grant shall be in addition to all other grants or similar assistance provided by the State prior to the initial request for guarantee assistance under this section.

Section 6(b) (1) limits the maturity of any obligations issued under this section to three months.

Section 6(b) (2) limits the total amount of the guarantee authority to $500 million.

Section 6(b) (3) states that the term “issuer” includes any municipality on behalf of which an obligation under this section is issued for the purpose of assisting that municipality in meeting its credit needs.

**Emergency Municipal Debt Guarantee Fund**

Section 7(a) establishes in the Treasury an emergency municipal debt guarantee fund, administered by the Board, to be used for payment of the Board’s expenses and for fulfilling the Board’s obligations under the Act. Moneys in the fund not needed for current operations may be invested in obligations of the United States or any Federal agency, and moneys not needed for current or future obligations may be paid into the general fund of the Treasury.

Section 7(b) requires that there be deposited in the fund any guarantee fees paid into the Act, any payments under general revenue sharing or other Federal assistance programs waived by a State or municipality to cover losses, or any other sums received by the Board.
Section 7(c) provides that payments required to be made as a result of any guarantee by the Board shall come out of the fund, and if there is not enough money in the fund, then the Secretary of the Treasury is authorized to borrow in order to make these payments.

Section 7(d) provides that the Federal Financing Bank shall purchase all obligations guaranteed under the Act so long as they are tax-exempt rather than taxable.

FEDERAL RESERVE BANKS AS FISCAL AGENTS

Section 8 authorizes Federal Reserve Banks to act as fiscal agents for the Board.

PROTECTION OF GOVERNMENT'S INTEREST

Section 9(a) authorizes the Attorney General to act to enforce any right of the Federal Government stemming from guarantees issued under the Act. It provides that any sums recovered pursuant to this section be paid into the fund.

Section 9(b) authorizes the Board to recover the amount of any payments made as a result of guarantees furnished under the Act from the issuer of the obligations guaranteed.

REPORTS

Section 10 requires the Board to submit quarterly reports to Congress on its operations under the Act.

TERMINATION

Section 11 provides that the authority of the Board to make any guarantee under section 5 terminates on June 30, 1979, and under section 6 on March 31, 1976. Such termination does not affect the carrying out of commitments entered into prior to that date or the taking of actions to preserve or protect the interest of the United States.

STOCK TRANSFER TAX

Section 12 amends Section 98(d) of the Securities and Exchange Act to permit a State or political subdivision to impose a transfer tax where the basis of the tax is the transfer and issuance of a new certificate by a transfer agent.
MINORITY VIEWS

We are opposed to the bill reported by the Committee. In our opinion, the bill would require a massive involvement in the affairs of New York City and State from which the Federal Government may not be able to extricate itself for years to come. The bill sets unrealistic goals for private investor participation and municipal union cooperation as a precondition for containing Federal guarantors. There is also reason to believe that the bill seriously underestimates the amount and duration of the debt obligations that will ultimately need to be guaranteed by the Federal Government. The bill will not eliminate the possibility that New York State could default, nor will it guarantee access to credit markets for other States or municipalities. Furthermore, the bill rewards bad management on the part of the city by elevating its securities to a preferential position in financial markets, and it sets an unwarranted precedent for other municipalities to seek Federal assistance. Finally, the bill discourages the city and the State from taking the appropriate and constructive steps needed to avert default.

We are not convinced that the advantages of providing Federal assistance to avoid default outweigh the threat which such a precedent would have to the separation of powers and responsibilities under our Federal system of government. Nor are we able to convince ourselves that the Federal Government should ask the public to assume the risk associated with providing a Federal guarantee for New York City obligations—a risk the public did not seek and one which private investors are apparently unwilling to bear. For these reasons, we recommend that the Senate not pass the bill reported by the Committee.

Faced with the possibility of a default by New York City on its obligations to holders of city securities, the Committee considered three courses of action. One approach was to prevent default by providing a Federal guarantee to assure the city would have adequate funds to meet its obligations as they become due. A second approach was to provide Federal loans to maintain essential city services during any period of cash shortage which could develop should default occur. Finally, the Committee considered the option of providing no Federal assistance either before or after default.

The bill reported by the Committee embodies the first of these three approaches. In our opinion, there are serious drawbacks to this approach.

First, the bill will lead to massive Federal involvement in the affairs of New York City and the State, and expose the Federal Government to substantial financial risks, for many years to come. We discount the limited duration and amount of Federal involvement envisioned under the bill reported by the Committee for a number of reasons. For one thing, the ability of the city to meet the preconditions for obtaining a Federal guarantee, largely to roll over its short term obligations,
will become more difficult over time. Moreover, the incentive for bringing the budget back into balance will be lost once the city has secured a Federal guarantee of its obligations.

As a precondition for obtaining a Federal guarantee of its debt obligations, the city would be required under the bill to secure the participation of private investors in the purchase of the city's unguaranteed securities on an ever-expanding scale. The anticipated extent of such private involvement would become less realistic over time. The city may be able to place the $1.2 billion unguaranteed securities required during the last seven months of this fiscal year in order to obtain a Federal guarantee of $2.5 billion during that same period. Beyond that, however, the city would be required to place a total of $5.4 billion in unguaranteed debt obligations with private investors up through fiscal year 1980. Given the attitude of financial markets toward New York obligations, this appears highly unrealistic.

It is argued by proponents of the reported bill that maturing debt should be subtracted from the total amount sold to focus attention on the net incremental borrowing by the city. This argument implies, however, that as bonds mature, their holders will reinvest their principal in new unguaranteed debts of New York City. A more realistic assumption would appear to be that many holders of New York debt, if they could recoup their principal, would be extremely reluctant to reinvest in unguaranteed New York City debt.

By the same token, municipal unions will have to make major concessions regarding pensions and salaries as a precondition for the city receiving a Federal guarantee of its obligations. Union leaders have already indicated their unwillingness to make such concessions, and their resolve could be strengthened once Federal guarantees have been secured.

To be sure, once the initial guarantee has been extended, the Federal Government could simply refuse to extend new guarantees to cover maturing obligations of the city if the preconditions for obtaining such guarantees are not met. By then, however, the financial interests of the Federal Government will be intertwined with the financial affairs of the city. The Federal Government will be faced with the likelihood of losing billions of dollars under already-outstanding guarantees or extending additional guarantees to avoid incurring such losses. Under the bill reported by the Committee, the maximum exposure facing the Federal Government could total $1 billion to fiscal year 1976 alone and $2.5 billion in fiscal year 1977. It can and will be argued that there is never a good time to permit a default by New York City. The end result will be that, in an effort to prevent a default from occurring, the Federal Government would become entangled in the city's financial affairs and policy decisions for an indefinite period into the future and on a scale yet unanticipated.

In addition, the extent to which Federal assistance would be needed to avoid default is unknown. The bill reported by the Committee provides for a maximum of $1 billion in guarantees this fiscal year. The maximum amount of guarantees which could be outstanding at any one time would decline each year thereafter. However, estimates by New York City officials of the need for Federal assistance through guarantees range as high as $9 billion. The fact is that accurate figures
on how much aid would be required under the approach embodied in the reported bill simply do not exist.

Moreover, as time goes on, the Spartan city budget contemplated under this "emergency" legislation may well be considered too restrictive by New York City officials. It is not hard to imagine appeals from city officials within the next few years for increased billions of dollars in guarantees beyond those contemplated in the bill to permit the city to undertake capital projects which are "urgently needed" to prevent deterioration of the city's plant and equipment.

Second, a principal argument for providing Federal credit to New York City is that a default by the city is likely to cause a default by New York State. However, preventing a default by New York City will not necessarily prevent a financial crisis for New York State, especially in light of a reported probable default by New York State's "moral obligation agencies" no matter what is done for New York City.

Third, the bill's proponents have not demonstrated that the "ripple effect" of a New York default will produce undesirable restrictions on State and local borrowing, and some witnesses before the Committee expressed the opinion that the market had already discounted a New York City default. Default by New York City will no doubt cause purchasers of State and local government obligations to be more cautious, a result which in light of New York City's experience may not be wholly inappropriate.

More importantly, even if the "ripple effect" were significant, there is no assurance that by providing a guarantee to New York City alone, the Federal Government can make other municipal securities more attractive to investors. There is no reason to believe that investors will be more inclined to invest in the municipal securities market just because New York City is able to avoid default by obtaining a guarantee on its debt obligations.

Fourth, the bill would permit the introduction of a new security into the market—a tax exempt, federally-guaranteed security. This type of security would be afforded a preferential position in financial markets, even over that available to the U.S. Government. Billions of dollars worth of these securities could be issued over the next few years, and it is difficult to imagine that other State or municipal borrowers will not be forced to pay higher rates on their "unguaranteed" obligations. The bill would make the least creditworthy borrower the most creditworthy. Other communities may well ask why they should not be given a guarantee also or become second class municipal borrowers simply because they have managed their affairs better than New York City.

Fifth, the proponents of the reported bill argue that in the event of a default, New York City would experience a sharp decline in property tax revenues because the New York State Constitution limits property tax collections to 9 1/2 percent of assessed valuation, and any real estate tax above that percentage must be used to service debt. This argument presumes that the city would be deprived of such revenues in the event of a temporary suspension of debt service, a presumption which is open to question, especially in light of the fact that the city will ultimately have to repay all or most of the principal and interest on its debt. Even if the courts were to hold that the city
could not collect real estate taxes in excess of 2½ percent of assessed value, nothing would prevent the city, with State approval, from imposing alternative taxes to replace the real estate taxes which it is argued could not be collected under the cited provision of the State constitution.

Sixth, it is also argued by the proponents of Federal Government action to prevent actual default by New York City that, in default, State laws would prevent financial institutions in many States from investing in New York City obligations for year after default. These State laws were passed for a very good reason: to prevent financial institutions from investing in securities issued by borrowers with histories of financial irresponsibility. To argue that the Federal Government should guarantee New York securities in order to maintain a market for them is tantamount to arguing that the Federal Government should act to circumvent State laws. If the Congress wishes to overturn State laws regarding fiduciary responsibility, it should address that issue directly.

Finally, even if the bill were workable, which we believe it is not, further debate about its merits seems to us to be an exercise in futility. The President has unequivocally stated that he is “prepared to veto any bill that has as its purpose a Federal bail-out of New York City to prevent default.” Even the bill’s proponents admit that it has only a slim chance of passing the Congress, and it’s difficult to find anyone who believes there is any chance of overriding a Presidential veto of such a bill. Both the Congress and the President are anxious to assure the continuation of essential services to the residents of New York City, whether or not the city defaults. Since legislation designed to prevent default has been ruled out by the President, it seems to us that the Congress would do better to address itself to legislation designed to permit an orderly reorganization of New York City’s debt, under revisions in the Federal bankruptcy law, and to assure the continuation of vital services should default occur. This would leave the matter of debt restructuring up to the courts. Under the President’s plan, the Federal Government’s exposure to risks would be minimized.

If Congress wants to act responsibly and help the citizens of New York, it should focus on what is possible and what is really in the public interest. It seems to us that the bill reported by the Committee will only raise false hopes in the minds of the citizens of New York that Federal assistance is on the way. This could act to discourage the city and the State from pursuing whatever steps can be taken to prevent default.

It is expected that if New York City defaults, it will experience a drastic shortage of funds to meet its expenses between the time of default and March of 1976. This shortage is primarily due to the seasonality of the city’s tax revenues, which are high in the spring but low in the winter. The President has recognized this problem in his proposal for a revision of the bankruptcy laws to permit the city to raise funds by the issuance of “debt certificates”, which would be secured by a first claim on tax revenues.

As noted above, the second approach considered by the Committee was to provide Federal loans to maintain essential city services during any period of cash shortage which could develop should default occur.
The President's proposal could be supplemented by this second approach, which recognizes that the marketability of the debt certificates proposed under the President's plan is open to some question.

The amount of any loan made under the second approach would be determined by a Municipal Debt Guarantee Board consisting of the Secretary of the Treasury, the Secretary of Labor, and the Chairman of the Board of Governors of the Federal Reserve System. A somewhat comparable provision for maintaining essential city services in the event of default is contained in the loan guarantee bill reported by the Committee. However, the reported bill contemplates that the Federal Government would first attempt to prevent default by providing loan guarantees, an approach which is unworkable and holds little hope for being enacted into law. Also, under the second approach which the Committee considered, the Federal Financing Bank would be authorized to purchase debt obligations of otherwise creditworthy States or municipalities which are unable to market their obligations because of a disruption in the market caused by the default of a major borrower like New York City, but no such provision is contained in the reported bill. The Committee failed to adopt the second approach as a substitute for the reported bill by a vote of 7 to 6.

The final option which the Committee considered and rejected was to provide no Federal assistance and to allow the city and State to take whatever actions are necessary to avoid default or deal with its consequences.

New York is our nation's largest city and the financial capital of the country. It is a major commercial center and provides a forum for world political discussion. Moreover, the residents of New York make significant contributions to our culture. No American who understands the important role New York plays in our national economy and culture can fail to wish the city well. Certainly, we do not want to see New York City default on its outstanding obligations, and our opposition to this bill should not be interpreted to mean that we favor default. However, it is our considered judgment that the reported bill is unworkable, stands virtually no chance of enactment into law, raises false hopes for the citizens of New York City, and is not in the public interest.

John Tower,
Edward W. Brooke,
Jesse Helms,
Jack Cain,
Robert Morgan.
ADDITIONAL VIEWS OF SENATOR EDWARD W. BROOKE

There is a legal maxim that hard cases make bad law, and by the same token, I am afraid that, confronted with the thorny issue of New York City's fiscal crisis, the Congress may be tempted to pass bad legislation.

New York City's problems are many and intertwined. Yes, New York has absorbed large numbers of low-income immigrants, both from abroad and from sections of our own country, as have some of our other Northeastern cities. Yes, New York has attempted to provide a decent standard of living for its lower income residents, as have some of our other cities. Yes, New York, like other cities, has watched many of its middle and upper income residents move to suburban enclaves, zoned to protect them from the problems of the poor who remain in the city. But New York City has also grossly mismanaged its affairs.

The city's municipal work force grew from approximately 243,000 in 1960 to almost 300,000 in 1975, while its population declined from approximately 7,800,000 to approximately 7,500,000 over the same period. City employees enjoy pensions and fringe benefits which are generous by any standard and are beyond the financial means of the city. The city has subsidized not only its poor, but its middle and upper income residents, through such devices as rent controls and free college education regardless of income. And the city has engaged in budgetary gimmickry to such an extent that even today it is impossible to determine with any confidence the true state of the city's finances.

I am firmly convinced that the problems of our older cities and the lower income families who live in them deserve a higher priority on our national agenda. But, I do not see in the reported bill the answer to these problems. If welfare reform is needed, and I believe it is, then let us get on with it. If the suburbs are forming an economic noose around the necks of our cities, then let us consider ways to cut that noose. If there are limited resources to solve our Nation's problems, then let us work harder to be sure that there is at least enough for all to have a decent standard of living.

We must begin to deal with the problems of our cities, and we must begin now. But I am convinced that the solution to our urban problems does not lie in a debt guarantee bill which seems, at least to me, to ratify municipal mismanagement and to reward many of those who have permitted the city to drift to the brink of financial collapse.

I have stated in Committee and I reiterate here that I am prepared to offer and to work for legislation designed to assure that residents of New York City are not deprived of vital services if a default occurs, but I cannot support the reported bill. My specific concerns about the provisions of the reported bill are set out in the Minority Views printed above.

EDWARD W. BROOKE.
ADDITIONAL VIEWS OF SENATOR HELMS

While I agree with the thrust of the analysis of New York City's problem in the Minority Views, it is my belief that they do not adequately address the question of Federal financial participation subsequent to default, should default occur. It is my view that such participation will serve only to prolong the ordeal, and establish a precedent involving Federal funding in vast new areas on the State and local level. Any such action will, in fact, be a requirement that the taxpayers throughout the Nation pay for the excesses and mismanagement of New York City. I do not care to participate in the imposition of any such requirement.

Jesse Helms.
<table>
<thead>
<tr>
<th>Initial</th>
<th>Time of Day</th>
</tr>
</thead>
<tbody>
<tr>
<td>BBA</td>
<td></td>
</tr>
<tr>
<td>HAD</td>
<td></td>
</tr>
<tr>
<td>LSD</td>
<td></td>
</tr>
<tr>
<td>MFF</td>
<td>A.M.</td>
</tr>
<tr>
<td>PGG</td>
<td></td>
</tr>
<tr>
<td>LAH</td>
<td>P.M.</td>
</tr>
<tr>
<td>EJK</td>
<td></td>
</tr>
<tr>
<td>WJL</td>
<td>MAIL</td>
</tr>
<tr>
<td>FGR</td>
<td></td>
</tr>
<tr>
<td>LWS</td>
<td></td>
</tr>
<tr>
<td>MCS</td>
<td>HAND</td>
</tr>
<tr>
<td>SJW</td>
<td></td>
</tr>
</tbody>
</table>
IN THE SENATE OF THE UNITED STATES

November 4, 1975

Mr. Proxmire, from the Committee on Banking, Housing and Urban Affairs, reported the following bill; which was read twice and ordered to be placed on the calendar.

A BILL

To provide for a voluntary reorganization of municipal debt under conditions of fiscal reform, and for other purposes.

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

SHORT TITLE AND STATEMENT OF PURPOSE

Section 1. (a) This Act may be cited as the "Voluntary Municipal Reorganization Act of 1975".

(b) The Congress finds that it is in the national interest to prevent the default by State or local governments on their outstanding obligations in a manner consistent with sound fiscal reform, as required under section 5 of this Act, and to establish a temporary program of emergency credit...
assistance to State or local governments unable to meet the
requirements of section 5.

DEFINITIONS

Sec. 2. As used in this Act—

(1) "Board" means the Emergency Municipal
Fiscal Reform Board;

(2) "assisted municipality" means a city incorpor-
rated under the laws of a State and any governmental
agency, public authority, or public benefit corporation
which receives or may receive moneys directly, in-
directly, or contingently (other than moneys received
for the sale of goods or the rendering of services or the
loan of moneys to the city) from that city;

(3) "State" means the State of the United States
which has jurisdiction of the assisted municipality, in-
cluding an agency of that State; and

(4) "Governor" means the chief executive officer
of a State.

ESTABLISHMENT OF THE BOARD

Sec. 3. There is established an Emergency Municipal
Fiscal Reform Board composed of the Secretary of the
Treasury, as Chairman, the Chairman of the Board of Gov-
ernors of the Federal Reserve System, and the Secretary of
Labor. Decisions of the Board shall be made by majority
vote.
AUTHORITY

Sec. 4. The Board, on such terms and conditions as it deems appropriate, is authorized—

(1) to guarantee or make commitments to guarantee the timely payment of principal and interest to holders of obligations to be issued by a State on behalf of an assisted municipality in order to prevent a default and carry out fiscal reform in accordance with section 5; or

(2) in the event of a default or other inability of an issuer to meet its obligations, to provide emergency guarantees of the timely payment of principal and interest to holders of obligations of that issuer or of a trustee or receiver of that issuer or of a State on behalf of an assisted municipality to support the provision by that issuer or assisted municipality of essential services in accordance with section 6.

Such obligations shall, to the extent feasible, be secured by a first lien on all future revenues of State or other issuer.

STANDARDS AND CONDITIONS FOR GUARANTEES TO PREVENT DEFAULT

Sec. 5. (a) No guarantee shall be made by the Board under this section unless—

(1) the Board finds that the obligations to be guaranteed are to be issued by a State for the purpose of
financing the credit needs of a municipality subject to
its jurisdiction, that the State and the assisted municipal-
ity are not able to obtain such credit in the private
market, and that the failure to obtain such credit is likely
to cause the assisted municipality or State to default on
its outstanding obligations;

(2) the assisted municipality submits, with the ap-
proval of the Governor of the State, in such detail and in
accordance with such accounting principles as the Board
may prescribe, a financial plan which in the judgment
of the Board will bring the assisted municipality's operat-
ing expenses (including debt service) into balance with
its recurring revenues beginning with its second full
fiscal year following the initial application for assistance.

Such financial plan shall provide for reductions in the
cost of employee pension plans to the assisted munici-
pality through reductions in the level of benefits, limita-
tions on the amount of overtime pay which can be
counted in computing retirement benefits, increases in
the amount of employee contributions, or otherwise.

Such financial plan shall also provide for the maximum
feasible participation by the employee pension funds
of the assisted municipality in supplying the credit
needs of the assisted municipality. Such financial plan
may be revised from time to time with the approval of
the Board;

(3) the State demonstrates that it has the au-

thority to control the fiscal affairs of the assisted

municipality for the entire period during which the Fed-
eral guarantee will be outstanding, including the author-

ity to determine all revenue estimates, set aggregate

expenditures limits, disapprove all expenditures not in

compliance with the plan required under paragraph (2),

approve all borrowing, and authorize all contracts during

that period;

(4) the State provides assurances satisfactory to

the Board that it will repay any losses the United States

Government may sustain as a result of payments made

pursuant to a guarantee under this section, and in fur-

therance of such assurances, the State and assisted

municipality agree to waive the right to all payments

which they would otherwise be entitled to receive under

the State and Local Fiscal Assistance Act of 1972, or

other comparable general purpose financial assistance

from the Federal Government, at such time and in such

amounts as the Board may determine to be necessary

to reimburse the United States for any losses sustained
as a result of payments made pursuant to a guarantee under this section;

(5) the assisted municipality agrees (i) to make available to the Board, the Comptroller General of the United States, and any certified public accountant designated by the Board all its accounts, books, records, documents, or other information which the Board may request bearing on its financial situation prior to, and during, the entire period in which the Federal guarantee is outstanding; (ii) to follow such generally accepted accounting principles as the Board may prescribe; and (iii) to provide such periodic reports as the Board may require;

(6) the State agrees to pay to the Board such guarantee fee as may be prescribed by the Board but not to exceed 3\(\frac{1}{2}\) per centum, per annum, of the total principal amount of guaranteed obligations outstanding, except that such fee shall not exceed 1 per centum if the interest on the obligations is included in gross income for the purpose of the Federal income tax laws;

(7) the State agrees to provide in accordance with this paragraph and at such times as the Board may prescribe a grant to the assisted municipality for each of the municipality’s fiscal years during which a guar-
antee under this section may be outstanding. Such a
grant shall—

(A) be in an amount equal to at least one-half
of the anticipated operating deficit of the assisted
municipality for the fiscal year or portion thereof
during which a guarantee under this section is out-
standing as determined without regard to the
amount of the grant in accordance with accounting
principles prescribed by the Board;

(B) be derived from the general tax revenues
of the State;

(C) be in addition to all other grant or similar
assistance provided to the assisted municipality by
the applicant or the State pursuant to programs es-
tablished or commitments made prior to its initial
request for a guarantee under this section;

(D) be provided at such times as the Board
may prescribe; and

(E) be used by the assisted municipality to
meet its operating expenses in accordance with the
financial plan under paragraph (2); and

(8) the State presents voluntary agreements
acceptable to the Board by the holders of obligations
issued by or on behalf of the assisted municipality to
exchange such obligations as prescribed herein. Such agreements may be conditioned upon the approval of guarantee assistance under this section and shall reduce the financial burden on the assisted municipality in such manner and degree as the Board may determine necessary to enable the assisted municipality to meet all its credit needs without further Federal guarantee assistance at the earliest practicable date. Such voluntary agreements shall not be accepted by the Board unless—

(A) the holders representing at least 65 percent of the aggregate principal amount of the obligations issued by a State agency on behalf of the assisted municipality agree to exchange those obligations for bonds issued by that agency with serial maturities of not less than five years and bearing interest at such rates as the Board may determine are necessary to achieve the purposes of this paragraph, but in no case may a holder receive a bond with an earlier maturity than the obligation exchanged; and

(B) the holders representing at least 40 percent of the aggregate principal amount of the obligations of the assisted municipality maturing prior to June 30, 1976, agree to exchange those obligations for bonds issued by the municipality with
serial maturities of not less than five years and
bearing interest at such rates as the Board may de-
determine are necessary to achieve the purposes of
this paragraph.

(b) (1) The maturity of any obligations guaranteed
under this section may not exceed one year.

(2) The aggregate principal amount of obligations
guaranteed by the Board under this section shall not exceed
at any time $4,000,000,000 prior to June 30, 1977;
$3,500,000,000 during the twelve-month period ending
June 30, 1978; $2,500,000,000 during the twelve-month
period ending June 30, 1979; and $1,500,000,000 during
the twelve-month period ending June 30, 1980.

(3) The Board may not make any commitment to
guarantee any obligations under this section during any
period when it determines the State or the assisted munici-
pality is not meeting its obligations under this section or that
the plan required under paragraph (2) of subsection (a) is
not being achieved on schedule.

(4) In approving guarantees under this section subse-
quent to June 30, 1976, the Board shall require, to the
maximum extent feasible, that investors participate in sup-
plying the credit needs of the assisted municipality without
Federal guarantee assistance by purchasing bonds issued
by the municipality with serial maturities of not less than
S. 2615—2
five years so as to eliminate the need for Federal guarantee
assistance at the earliest possible date, but in no event later
than June 30, 1979.

STANDARDS AND CONDITIONS FOR GUARANTEE OF OBLIGA-
TIONS OF ISSUERS IN DEFAULT

Sec. 6. (a) The Board may not guarantee obligations
under this section unless—

(1) the Board finds that—

(A) assistance under section 5 cannot be pro-
vided because of a failure to meet the requirements
of that section;

(B) the issuer of the obligations (i) has de-
faulted on its outstanding obligations, or (ii) has
filed a petition under the Bankruptcy Act;

(C) the issuer is unable to obtain credit in the
private market; and

(D) a guarantee under this section is neces-
sary to permit the issuer to carry on essential serv-
ices or programs the interruption of which would
endanger the health, safety, or welfare of the resi-
dents of the affected area;

(2) the issuer submits a financial plan acceptable
to the Board in such detail and in accordance with such
accounting principles as the Board may prescribe, for
bringing its recurring revenues into balance with its
essential cash needs;

(3) the issuer provides assurances satisfactory to
the Board that it will repay any losses the United States
Government may sustain as a result of payments made
pursuant to a guarantee under this section, and in further-
ance of such assurances the issuer agrees to waive the
right to all payments which such issuer would otherwise
be entitled to receive under the State and Local Fiscal
Assistance Act of 1972, or other comparable general
purpose financial assistance from the Federal Govern-
ment, at such time and in such amounts as the Board
may determine to be necessary to reimburse the United
States for any losses sustained as a result of payments
made pursuant to a guarantee under this section;

(4) the issuer agrees to—

(A) make available to the Board and the
Comptroller General of the United States all its ac-
counts, books, records, documents, transactions, and
any other information bearing on its financial situ-
action which the Board may request prior to and dur-
ing the entire period during which a Federal guar-
antee is outstanding;
(B) follow such generally accepted accounting principles as the Board may prescribe; and

(C) provide such periodic reports as the Board may require;

(5) the issuer agrees to pay to the Board such guarantee fee as may be prescribed by the Board but not to exceed 3½ per centum per annum of the total principal amount of guaranteed obligations outstanding, except that such fee shall not exceed 1 per centum if the interest on the obligations is included in gross income for the purpose of the Federal income tax laws; and

(6) in the case of an issuer which is a unit of local government, the State in which such issuer is located agrees to provide from its general tax revenues and at such times as the Board may prescribe, a grant to such unit in an amount equal to one-half of its anticipated operating deficit during any period when a Federal guarantee under this section may be outstanding as determined without regard to the amount of such grant in accordance with accounting principles prescribed by the Board. Such grants shall be in addition to all other grants or similar assistance provided to such issuer by the State pursuant to programs established or commitments made prior to the initial request for guarantee assistance under this section.
(b) (1) The maturity of any obligations guaranteed under this section shall not exceed three months.

(2) The aggregate principal amount of obligations guaranteed under this section shall not exceed, at any time, $500,000,000.

(3) For the purpose of this section, the term "issuer" includes any municipality on behalf of which an obligation under this section is issued for the purpose of assisting such municipality in meeting its credit needs.

EMERGENCY MUNICIPAL DEBT GUARANTEE FUND

Sec. 7. (a) There is established in the Treasury an emergency municipal debt guarantee fund (hereinafter referred to as the "fund") to be administered by the Board. The fund shall be used for the payment of the expenses of the Board and for the purpose of fulfilling the Board's obligations under this Act. Moneys in the fund not needed for current operations may be invested in direct obligations of, or obligations that are fully guaranteed as to principal and interest by, the United States or any agency thereof. Moneys in the fund not needed for current operations or for any future obligations shall be covered into the general fund of the Treasury.

(b) Guarantee fees paid under this Act shall be deposited in the fund. Notwithstanding any other provision of law, the Secretary of the Treasury shall deposit in the fund any payment, or portion thereof, which a State government or
unit of local government would otherwise be entitled to receive under the State and Local Fiscal Assistance Act of 1972, or any other comparable program of general purpose financial assistance from the Federal Government, and which is waived by such Government pursuant to this Act. Any other sums received by the Board under this Act shall be paid into the fund.

(c) Payments required to be made as a consequence of any guarantee by the Board shall be made from the fund. In the event and to the extent that the moneys in the fund are insufficient to make such payments, the Secretary of the Treasury is authorized and directed to make such payments on behalf of the Board and for that purpose he is authorized to use as a public debt transaction the proceeds from the sale of any securities issued under the Second Liberty Bond Act, as amended, and the purposes for which securities may be issued under that Act are extended to include any such payments.

(d) The Federal Financing Bank shall purchase all obligations guaranteed under this Act the interest on which is excluded from gross income for the purposes of the Federal income tax laws.

FEDERAL RESERVE BANKS AS FISCAL AGENTS

Sec. 8. Any Federal Reserve bank which is requested to do so shall act as fiscal agent for the Board. Each such fiscal agent shall be reimbursed by the Board for all expenses and
losses incurred by it in acting as agent on behalf of the Board.

PROTECTION OF GOVERNMENT'S INTEREST

Sec. 9. (a) The Attorney General shall take such action as may be appropriate to enforce any right accruing to the United States or any officer or agency thereof as a result of the issuance of guarantees under this Act. Any sums recovered pursuant to this section shall be paid into the fund.

(b) The Board shall be entitled to recover from any issuer of an obligation guaranteed under this Act or any other person liable therefor, the amount of any payments made pursuant to any guarantee made under this Act, and upon making such payments, the Board shall be subrogated to all the rights of the recipient thereof.

REPORTS

Sec. 10. The Board shall submit a quarterly report to the Congress as to its operations under this Act.

TERMINATION

Sec. 11. The authority of the Board to make any guarantee under section 5 terminates on June 30, 1979, and under section 6 on March 31, 1976. Such termination does not affect the carrying out of any contract, guarantee, or other obligation entered into pursuant to this Act prior to that date, or the taking of any action necessary to preserve or protect the interest of the United States in any amounts
advanced or paid out in carrying on operations under this Act.

**STOCK TRANSFER TAX**

Sec. 12. The first sentence of section 28(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78bb(d)) is amended to read as follows: "No State or political subdivision thereof shall impose any tax on any change in beneficial or record ownership of securities effected through the facilities of—

"(1) a registered clearing agency; or

"(2) a registered transfer agent when performing the function described in section 3(a) (25) (E) of this title or, in connection with such function, any functions described in section 3(a) (25) (B) through (D) of this title,

or any nominee thereof or custodian therefor or upon the delivery or transfer of securities to or through or receipt from such agency or agent or any nominee thereof or custodian therefor, unless such change in beneficial or record ownership or such transfer or delivery or receipt would otherwise be taxable by such State or political subdivision if the facilities of such registered clearing agency, registered transfer agent, or any nominee thereof or custodian therefor were not physically located in the taxing State or political subdivision."