INTERGOVERNMENTAL EMERGENCY ASSISTANCE ACT

NOVEMBER 6, 1955.—Ordered to be printed.

Mr. Recus, from the Committee on Banking, Currency and Housing, submitted the following:

REPORT

together with

ADDITIONAL, INDIVIDUAL, SUPPLEMENTAL, MINORITY, AND DISSSENTING VIEWS

[To accompany H.R. 10481]

The Committee on Banking, Currency and Housing, to whom was referred the bill (H.R. 10481) to authorize emergency guarantees of obligations of States and political subdivisions thereof; to amend the Internal Revenue Code of 1954 to provide that income from certain obligations guaranteed by the United States shall be subject to taxation; to amend the Bankruptcy Act; and for other purposes, having considered the same, report favorably thereon, with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

Page 3, line 7, strike out "1031" and insert "101 (d)".

Page 1, line 17, strike out the semicolon and insert the following:

in amounts and terms sufficient to meet the municipality's financing needs during the period covered by the plan required to be submitted pursuant to section 105 (a) (2) of this title;

Hearings

The Subcommittee on Economic Stabilization of the Committee on Banking, Currency and Housing held 5 days of hearings on the matters covered by this legislation. The purpose of the hearings was to develop information relative to the following areas of inquiry:

1. What is the current financial situation in New York City and how did this develop? What would be the consequences of default? What is needed to prevent default?
2. What is the precise financial involvement of New York State with respect to New York City's current crisis, and what problems have accrued to the State as a consequence of this involvement? What would be the consequences to the State of a New York City default? What is needed to prevent these consequences?

3. What are the national implications? How would default affect states, municipalities, other units of local government, in terms of their ability to borrow and to provide essential public services, and to maintain fiscal responsibility? What would be the impact on recovery and employment?

4. What are the international implications of default by New York City and/or New York State?

5. What is the nature and basis of a Federal response, if any, constitutionally, and in terms of other Federally-supported programs?

6. What kinds of intervention are available to the Federal Government, within the context of the central government's responsibility (if any) and which is the most appropriate? What should be the conditions for Federal involvement, if any?

Those heard in the course of these hearings included the Mayor and other public officials of the City of New York; representatives of public interest groups within the City of New York; the Governor of the State of New York; the Chairman of the State's Municipal Assistance Corporation, the Comptroller; and the Director of the Budget of the State. The Subcommittee also received testimony from representatives of banks within and without the State of New York and from the New York State Superintendent of Banks; and from representatives of the three federal bank regulatory agencies. Also appearing as witnesses were representatives of various elements of the securities industry and the heads of the two principal municipal bond rating services. Testimony was also received from the Mayors of other large cities, and from representatives of the U.S. Conference of Mayors, the National League of Cities, and the National Association of Counties. Among other witnesses who appeared were several who are expert in international economic and political relations, in the law of bankruptcy, in constitutional law, and in the legal aspects of municipal finance.

Testimony was received from representatives of the American Federation of Teachers and the American Federation of State, County and Municipal Employees.

Finally, the Subcommittee heard as witnesses the Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury.

**NEED FOR THE LEGISLATION**

1. **Effects of Default on New York City**

   Your Committee believes that in the absence of Federal guarantee assistance as provided in this legislation, your Committee believes that New York City will be forced to a default on the great majority of its $2.5 billion in short-term obligations maturing between December 1, 1975 and June 30, 1976, and that the effects of such a default would be lasting and destructive. In the immediate aftermath of a default, the city would face a shortfall of about $1.2 billion in the cash
which it requires for operating expenses and capital projects from December through March. Without Federal assistance, the city will probably find it impossible to market the tax anticipation notes which ordinarily meet that shortfall. Were that $1.2 billion not to be forth coming from any source, cuts amounting to about one-third of total city expenses exclusive of debt service would be required; these cuts would represent most of that part of the expense budget within the control of the Mayor. Mayor Beame has testified that such an event would leave the city virtually without police, firemen, sanitation, or schools. Vendors who supply the city's hospitals, schools, administration and essential services would not be paid; general shortages and a wave of personal bankruptcies might ensue. Your Committee believes that this could not be allowed, and therefore concludes that Federal guarantee assistance would be forthcoming through renewed legislative action in any event.

In addition, a default would have an adverse impact on the revenues of the city. An advance of $800 million, which the State of New York made to the city in the last fiscal year, would not be available again if the city defaulted. Since real estate taxes are tied to payment of debt service, the city may find it more expensive to collect its revenues in the event of default, producing an additional annual shortfall of perhaps $500 or $600 million. These additional, prospective shortfalls would have to be met with Federal assistance; and they would complicate the problems involved in the sale of tax anticipation notes. For this reason, your Committee believes that unguaranteed certificates of indebtedness, no matter what priority they might be given by a Federal bankruptcy court, could not provide an adequate flow of revenues to the city.

Over the long run, if one assumes that essential services are maintained after default and that the immediate consequences of failing to do so are averted, then in the absence of legislation providing for an orderly transition to a balanced budget, New York would be forced into bankruptcy. In all events, the flow of services to the citizens and corporations of the city would be significantly reduced and the tax burden would increase. The consequence would be renewed financial difficulties, perhaps a second bankruptcy, and a repetition of the cycle. Your Committee feels that such a course poses unacceptable costs on the city of New York, and on the citizens of the United States as a whole. It would be far better, and far less costly, to provide New York the means to work out of its current difficulty with Federal assistance. That is what the proposed legislation seeks to achieve.

2. Effects on the Municipal Bond Market

In its Background Paper No. 1 of October 10, 1975, entitled New York City's Fiscal Problem: Its Origins, Potential Repercussions, and Some Alternative Policy Responses, the Congressional Budget Office has described some of the adverse effects on the municipal bond market which might flow from a default as follows:

The impact of a New York City default on the municipal bond market is much more hazardous to predict than the impact on individuals and insurance companies. To date, the evidence indicates that New York's problems have had
little, if any, impact on the situation facing non-municipal borrowers. Yields on municipal issues have maintained their historic relationships to those on corporate issues of comparable maturity and quality. While municipal rates have edged up recently, so too have the rates for corporate and federal securities. Of course, it is possible that when more recent data are processed, they will show that a dramatic shift has taken place.

There are some significant exceptions to these generalizations. Investors have clearly started to shy away from low quality municipal offerings. However, the extent to which this is the by-product of New York’s difficulties rather than the competition from an unusually large quantity of high quality municipal and treasury offerings cannot be determined with precision. Some larger, older cities, especially those in the eastern and northeastern areas, have been forced to pay unusually high rates of interest, probably because of their superficial fiscal resemblance to New York. For example, the rate paid by Philadelphia rose from 6.5 percent in February to 8.5 percent in July. Detroit, partly because of its extremely high unemployment rate and its budgetary problems, has been forced to pay roughly 9 percent throughout 1973. The specter of a city default dragging down the state has forced New York State’s rate up to 8.7 percent. It also should be noted that certain borrowing agencies such as the Housing Financing Agency in New York and its sister organization in Massachusetts, both of which relied on rolling over short-term notes to avoid the high rates associated with long-term borrowing, have been forced out of the market completely because no syndicate will underwrite their bonds.

A default by New York City could cause this situation to become more widespread. Banks, individuals, and insurance companies may be unwilling to risk new capital in the municipal market until the dust from the city’s default settles. Fiduciaries may shy away from this market out of a fear that they would be liable for investing in risky securities. If such a reaction occurs, it would cause a widespread crisis among the states and localities that depend upon access to credit.

No one knows how many jurisdictions can avoid borrowing for a period of months, but undoubtedly a number of large cities and states would be forced into default, at least temporarily, if they were denied access to the bond market. For the most part, these jurisdictions would be those that had counted on rolling over or refinancing their bond anticipation notes. Those governments that depend upon revenue or tax anticipation borrowing need not default; rather, they would have to restructure suddenly their expenditure pattern to conform to their inflow of revenues. In some cases this would entail severe temporary service cutbacks. For the governments that borrow for long-term capital construction, a temporary
elusive of the credit market would mean a postponement of building schedules which would affect the level of activity in the construction industry.

It is also possible that the municipal bond market is fairly sophisticated and that it has differentiated on objective grounds the situation facing New York and a few other jurisdictions from that facing the vast majority of other municipal borrowers. In fact it has been suggested that the possibility of a default by the city may be largely or even fully discounted by the market already. If this is true, the major repercussion may well be a general feeling of relief that default, like impeachment, is a storm that can be weathered. A new sense of stability could return to the municipal market, especially if the city were able to reorganize its debt quickly and prove that it could meet the payment schedule on its restructured obligations.

2. Effects on the Banking System

Your Committee received much testimony on the effect of a New York City default on the banking system, much of it in disagreement. The testimony on behalf of the Board of Governors of the Federal Reserve System was that "the public need not fear for the stability of our banking system if a default does in fact take place." The Comptroller of the Currency testified that the effects would be "controllable," and the Chairman of the FDIC reported that, under certain assumptions, fewer than 30 of 8,000 nonmember insured banks surveyed would become causes for supervisory concern in the event of default. On the other hand, the Superintendent of Banks of New York State testified that a New York City default would have "severely adverse" consequences for the banking system. The Chairman of the Board of the Morgan Guaranty Trust Company of New York testified that, in his opinion, "the potential consequences of any default are essentially unknowable before the event".

The single greatest danger to the banking system in the event of a New York City default is the possibility that large holders of certificates of deposit at New York banks would withdraw their holdings and seek other sanctuary for them, perhaps abroad. Were this to occur, a substantial contraction of liquidity throughout the economy might ensue, with very severe consequences for the national banking system. The probability of such an occurrence seems slight, but in view of the substantial holdings by foreigners of large certificates of deposit in money market banks, and the unpredictability of their reaction to an event which is difficult for them to believe can happen, no statement about its consequences can be made with confidence.

A second significant danger to the banking system might arise if New York State and its agencies were forced to default in the wake of New York City. While testimony from regulators was in agreement that the number of banks placed in jeopardy by virtue of their excessive holdings of New York City paper is relatively small, most testified that the further default of the State would make matters considerably worse. Whether such a further default might trigger psychological reactions leading to collapse can only be guessed.
If one assumes that neither of the aforementioned disasters were to occur, then the effects of a New York City default on banks and other financial institutions which hold maturing New York paper may be summarized as follows:

First, all such banks would have to deduct from estimated revenues for the current fiscal year the interest payments on New York City obligations which would not be forthcoming.

Second, all such banks would be forced, eventually if not at once, to write off the book value of their holdings of New York City paper against their capital. To the extent that such a write-off would produce liquidity problems for some banks, the Federal Reserve Banks would stand ready to provide the necessary additional cash at the discount window. Federal regulators have assured your Committee that such write-offs would not be required until enough time had elapsed to determine the real value of such assets. If an exchange of defaulted debt for longer-term obligations can be affected within a short time, the capital write-down may be avoided altogether.

Third, certain banks may be subject to legal action on the part of their shareholders, as well as beneficiaries of trusts and other discretionary accounts, who may claim that the bank had either not been sufficiently prudent in diversifying its portfolio so as to minimize risk, or that the bank had not reviewed with sufficient caution the accounts of New York City over the long period.

The magnitude of such effects is difficult to gauge, in part because such surveys as were done by the regulatory agencies tended to exclude trust department holdings of New York City debt and to focus exclusively on that part of the debt held by banks for their own portfolios. Testimony received by the Committee indicates that 200-300 banks throughout the country would be seriously affected by a New York City default.

4. Effects Throughout the Economy

The default and bankruptcy of New York City will injure the economy of the United States. On this there is no doubt, and no disagreement. Your Committee does not know, however, how serious the effect will be. Within New York City and in the surrounding region, the effect will be severe; increased joblessness, curtailed services, and the possibility of personal and corporate bankruptcies. The psychological effect of a New York default on the rest of the Nation may produce similar defaults and similar consequences. On the other hand, the default and bankruptcy of New York City could trigger a national and international financial collapse. Your Committee believes, however, that to ignore the problem of New York City's insolvency would be to court an exceedingly large risk. It would also invite large, unanticipated Federal costs in direct assistance, in welfare and unemployment compensation, in lost taxes, etc., etc. Both the risk and the costs can be averted by the adoption of a plan which makes New York solvent again, but which provides a bridge whereby it can do so without a destructive economic convulsion. The proposed legislation provides for such a plan.
5. The Effects on America's International Position

What is the probable effect of a default by New York City on the financial markets of the world, and, secondly, on the longer-range political interests of the United States?

The answers to these questions are conditioned by the fact that people who live in states with centralized governments—which means most of the world—cannot understand the intricate relationships of power and responsibility between municipalities and states and the federal government in a true federal system such as our own. In England or France, it would be unthinkable for a major city to go bankrupt. In France, with a highly centralized system, the state exercises substantial control over the finances of local government units, and in Germany, ever since the depression years of the 1930s, the states have rigorously overseen the finances of municipalities. In Britain, the national government assumes such responsibility for the nation as a whole that there is no real possibility of default; the budgets of local authorities are approved each year by the British Treasury and no local authority can sell securities in the capital market without its approval.

Thus, when the Federal Government announces its refusal to assist New York, Europeans are perplexed and deeply disturbed, and some are even expressing suspicions that it is perhaps not only New York City that is in trouble but the Federal Government itself. The repercussions of a default would, of course, be considerably intensified if New York City's problems were to bring the State itself into difficulties.

Clearly, no one can measure the total impact, either on the parity of the dollar or on foreign securities markets if the Federal Government were to sit by while New York was forced to default. The answer would depend on a considerable extent on the impact which that event might have on United States financial markets, since we live in a world where interdependence is an economic and financial fact. The financial health of New York and other large American cities is an element of real significance to the stability of the world's financial and monetary system.

Consider, for example, these excerpts from recent releases provided by a witness who spoke in opposition to Federal assistance—communications from foreign correspondents all of whom he characterized as experts on international economic and financial affairs:

Frankfurt, Germany

Default would basically indicate that, generally speaking, important things are out of control in the United States. Until recently, it was unbelievable for the Europeans that anything like a default of a public authority would be feasible. In fact, it would be impossible in Europe. From this point of view it would be concluded that the situation must be really disastrous. Default will undermine the confidence in American institutions and thereby the confidence in American stability and recovery, and that could exercise further negative influence on our own recovery.
Switzerland

The prospect of a default of New York City last week had very little impact on our financial markets; I would say none at all. But the main reason for this is that nobody here believed that it could happen. I hate to imagine the consequences if it had happened.

Paris, France

It is very difficult for the French to admit that New York can default when Paris, Marseille and Lille cannot. In a country where financial solidarity goes hand-in-hand with national solidarity, the French cannot perceive of inhabitants of other states and cities being hostile to an intervention in behalf of New York City. Bankers now fear a weakening of the dollar and are beginning to worry about the large American banks if New York City cannot honor its obligations.

London, England

Generally, bond market has been concerned about possibility of higher interest rates in the event of New York default.

Tokyo, Japan

Most Japanese expect the Federal government will step in to save the city. This would be a logical Japanese solution to the problem.

The world financial system, and therefore our own national financial system, have been weakened by recent bank failures and by the world recession. The balance between optimism and pessimism, now heavily weighted on the side of pessimism, could possibly become even worse if the system were subjected to new and significant strains.

The world's financial markets are an indivisible network, even more integrated than the economies of the industrialized nations. The market for state and municipal bonds is an integral part of our own financial system, and therefore of the world financial system. A loss of investor confidence in municipal bonds, driving up interest rates in that sector of the American market, would have effects on the entire structure of interest rates and stock prices here and throughout the world. There is no way in which these events can be isolated since money flows freely to and from every part of the financial system, nationally and internationally.

Certainly no one can read the European financial press without realizing that New York's problems have created apprehension. European political and financial circles would attribute what they regard as the willful and arbitrary refusal of the Federal Government to intervene to irresponsible domestic politics. They are worried that the impact of default would depress the American economy at a time when they are counting on an American upswing to give a boost to their own faltering economies. They fear, in fact, that an American setback might precipitate a slide toward world depression.

Leaders in other countries do not, as do many Americans, confuse the bankruptcy of a corporation in the private sector (such as Lockheed) with the default by a major arm of Government. The default of a private company is, as they see it, a phenomenon quite
normal in the operation of a capitalist system but for the Federal Government to sit by immobilized while one of the great cities of the world defaults on its obligations would, however unfairly, raise questions as to the good faith of our political authorities and create doubts as to the responsibility of our national Government and, hence, the validity of its promises.

Witnesses before your Committee testified that default may also have an important impact on relations between the West and the Soviet Union as well as on Communist party activities around the world, particularly if that default should result from the failure of the Federal Government to come to New York's rescue and that criticism of capitalism throughout the world would interpret the default of New York City as a symptom of the sickness of American capitalism; their arguments would surely also carry weight with the peoples of countries whose economies may be injured if a New York default triggers an international economic contraction. Your Committee is concerned that the bankruptcy of an important arm of the American democratic system would dishearten those who seek to argue the case of democracy around the world, and especially in countries whose political futures are troubled and uncertain.

It is therefore a matter of high importance in the judgment of your Committee, both in our own economic interests, and in the interests of our national state in the solidarity of our international relations that we act promptly to avert the bankruptcy of the city of New York, and of other cities in trouble.

**Purpose of the Bill**

In order to provide the Federal Government with the necessary legal authority to deal promptly and effectively with an unprecedented financial crisis, the bill creates an emergency board consisting of three Cabinet officers and two independent agency chairmen, which is authorized to guarantee, under stringent conditions of eligibility, State agency obligations where that action is necessary to prevent or mitigate the effects of a municipal default.

The total amount of long-term obligations which could be under guarantee at any one time could not exceed $5 billion; this would drop to $3 billion in 1939, and all guaranteed obligations would have to have a final maturity in fiscal 1999 or earlier. In addition to the foregoing, outstanding guaranteed short-term (11-month or under) obligations could not exceed $2 billion at any one time.

While it is believed that both costs and risks would be minimized by timely action to forestall the occurrence of default, the bill is deliberately designed to enable the Administration to take action to forestall the destructive processes which default would set in motion, and to assist an orderly transition to a sound municipal fiscal structure in New York's largest city at the earliest practicable time.

**The Constitutionality of Federal Assistance to New York City and Its Impact on the Federal System**

In his statement before the Senate Committee on Banking, Housing and Urban Affairs on October 9, 1975, the Honorable William E. Simon, Secretary of the Treasury, indicated that assistance by the fed-
eral government to municipalities, and particularly to New York City, would present "grave practical and philosophical difficulties" in this it would contravene "constitutionally-imposed principles of federalism; principles which lie at the heart of the structure of government in this nation." It is your Committee's view that the constitutional opinion of the Secretary is untenable.

On the basis of expert testimony and written submissions for the record, it is the Committee's view that assistance by the Federal Government to New York City, whether by direct subsidy, purchase of securities, or guarantee of securities, would not violate any constitutional principles, and would, in fact, strengthen rather than weaken the structure of the federal system.

Congress has plenary power under the Constitution to decide to help prevent the bankruptcy of New York and other institutions established under the authority of the States in the exercise of its own responsibilities for the common defense and general welfare of the United States.

The problem in this case is the absence of that precedent in McCulloch v. Maryland. The reasoning of Chief Justice Marshall's opinion in that case established a firm Constitutional foundation for national action to assist New York and other cities (or States) in financial difficulties, if the Congress should determine such action to be in the national interest.

Constitutionally, there is no wall of separation between the states and the Nation. A State cannot challenge a decision of the nation in an area entrusted to the Constitution to the national authority. That was the issue at bar in McCulloch v. Maryland. But the constitutional problem is altogether different when the nation decides to help a city, or a city, without denying its legislative competence in any way. The basic reason for the difference is brought out in McCulloch v. Maryland itself. A State legislature cannot speak for more than the people of a State. Others are not represented. But Congress embodies the whole of the Nation. There is no reason why the whole Nation should not be free to help one of its parts, if it wishes to do so.

Congressional action to assist a city could rest on a number of specific constitutional grants of authority to Congress, and on all those grants viewed as an aggregate—the judicial approach used in McCulloch v. Maryland. Congress is of course constitutionally free to appropriate funds for the benefit of New York, so long as the broad political test of Article I Section 8 is met. Congress appropriates billions of dollars every year to support programs of housing, city planning, welfare, education, assistance to police forces, and so on affecting both cities and States. The United States owns large amounts of property in New York and other cities. It could, if it wishes, decide to make grants to those cities in lieu of local property taxes, as it does in communities where there are national parks and forests. Congress could find the financial health of New York a factor of importance to the stability of the national and the international monetary and financial system—as indeed is the case—and act accordingly in the exercise of its comprehensive powers in the fields of interstate and foreign commerce, money, finance, and foreign affairs.
Assistance by the federal government to the City of New York by guarantees of tax-exempt securities would involve the exercise by the Congress of its power to "lay and collect taxes... and provide for the general welfare of the United States."

This power, under Article I, Section 8 of the Constitution, is generally referred to as the taxing and spending power and, particularly with respect to the power to spend for the general welfare, has been regarded as one of the least restricted and most broadly inclusive powers of the Congress. Indeed, one may go so far as to say that there simply is no significant constitutional issue with respect to the Federal power to spend for the general welfare. The power is not constrained by any obligation to spend equally throughout the United States and, in fact, the power has never been exercised with any such constraints in mind. Thus, projects which primarily benefit one region or one part of the country are authorized to the same extent as spending programs whose benefit is spread evenly throughout the nation.

As we approach the Bicentennial Year, it is well to remember that one of the earliest exercises of the federal spending power was the assistance by the federal government of the original States comprising the Federal Union. The first Congress of the United States voted to have the federal government assume the debts incurred by the original States. Indeed, this particular exercise of the Federal spending power followed a historic debate in which the Hamiltonian view of the broad grant of the spending power prevailed over other views which would have limited the exercise of the spending power to objectives within the powers expressly delegated to Congress in Section 8.

In recent times the spending power has been exercised very frequently and very broadly for the benefit of State and local governments. Aside from recent exercises of spending power involved in the revenue sharing program, which constitutes a direct and relatively unlimited subsidy to the States, the spending power has most frequently been exercised through the familiar grant-in-aid mechanism of these programs—whether in the housing, public health, education, agriculture or environmental field—has been to provide for a grant or subsidy to State or local governments for particular purposes determined by Congress to be for the general welfare of the United States, imposing such conditions on the grant as the Congress finds useful or necessary. Thus, in a variety of categorical programs, State and local governments have been required to meet a variety of substantive standards—which frequently involve the promulgation of new State or local law or regulations—to meet the Federal conditions. It is clear that the grant-in-aid system which has provided the necessary means for State and local governments to engage in a variety of programs, such as in housing, public health or environment, has generally had the effect of strengthening rather than weakening the federal system because it has enabled the States and localities to undertake tasks and meet obligations which they would not otherwise have been able to do. Thus, a program of assistance to major cities in the United States, or to New York City specifically, would not involve an exercise of Federal power which is either unusual or a substantial departure from past practice.

Whether or not State and local powers are adversely affected so as to imbalance the federal system depends essentially on the nature of
the conditions imposed on the assistance. This, however, ceases to be a matter of constitutional limitation and becomes primarily a matter of sound and rational policy. The Congress is, of course, free to impose on States and municipalities any condition it desires (except conditions which violate the Bill of Rights) in return for the assistance. The city or state in turn is under no obligation to accept the federal assistance if the conditions appear too onerous or burdensome to it. In other words, the system of assistance is an affirmation of the federal system rather than its weakening or denial. Since a city or State is free to accept or reject such help, it does not act under federal compulsion but retains its choice, and the concept of municipal and state integrity within their own proper spheres in the federal system is preserved.

This is ample evidence that the imposition of federal conditions and requirements on states and municipalities has not and will not weaken the federal system, though indeed default by the city of New York would do so. The federal government has imposed far-reaching obligations on the States and localities under Social Security legislation, under the Fair Labor Standards Act, equal employment laws, and under a variety of other regulatory legislation. While clearly these laws have imposed obligations on the States requiring them to meet federal standards, and while the impact of these laws has sometimes been to increase fiscal burdens on State and local governments, there have been few assertions that these requirements have resulted in unconstitutionality inbalancing the federal system.

If assistance to New York City is regarded as a preferential and uneven exercise of federal power, the clear response is that such exercises of the power have invariably been justified—and properly so—on the grounds that they benefit the general welfare. Federal programs to provide local disaster and flood relief, to assist agriculture for industry in particular parts of the country, and to assist particular segments of the transportation or communications industry have always been justified on general welfare grounds. It cannot be asserted that a default by New York City with its far-reaching implications on the economy of the nation is not a matter which affects the general welfare. Hence, even if the city of New York were singled out for special federal aid, the legal justification lies in the need to provide for the general welfare of the Nation.

Federal assistance to New York City can also be justified on traditional grounds of the commerce power. Whatever the estimate of the consequences of a default by New York City on the economy of the Nation, there is little question but that such a default would greatly affect interstate commerce in municipal securities and could lead to a general loss of confidence in other securities as well. A New York City default would have far-reaching impact and effect on interstate commerce, and the prevention of such adverse impacts on interstate commerce is clearly within the established ambit of the commerce clause. It is hard to argue that the prevention of the adverse impact of default on interstate commerce is less justifiable an exercise of congressional power than the regulation of the adverse impact flowing from environmental damage, or the regulation of adverse effects of the payment of inadequate wages to workers employed in industry or in State and local government.
Title I of the bill sets forth the circumstances under which Federal aid may be made available to a distressed municipality in the form of a guarantee of State obligations which are issued for its benefit. Title II of the bill makes a confirming amendment to the Internal Revenue Code to provide that the interest on any obligations so guaranteed shall be subject to Federal income taxation. As reported by this Committee, the bill contains a heading for a Title III setting forth an amendment to the Bankruptcy Act in the event that a bill containing such provisions might possibly be reported by the Committee on the Judiciary and incorporated into H.R. 10181 by a later amendment. In the material which follows, under headings which correspond to the Title and section headings of the bill as reported, the legal effect and intended purpose of the provisions of Title I and II are discussed in detail.

Section-by-Section Analysis

§ 1. Short Title
This section provides that the short title of the Act is to be the Intergovernmental Emergency Assistance Act.

TITLE I—INTERGOVERNMENTAL EMERGENCY ASSISTANCE

§ 101. Definitions and rules of construction
This section sets forth definitions and rules of construction. The term “political subdivision” has developed an established legal meaning under the Internal Revenue Code, and this body of law is incorporated by reference. Section 103(d) makes clear that any action required under the Bill to be taken by a State can be taken by any agency or instrumentality of the State which is approved by the Board for that purpose. The Board must have due regard for the purposes of the State law creating any such agencies or instrumentalities.

§ 102. Establishment of the Board
This section sets up the Intergovernmental Emergency Assistance Board, which is vested with the discretion to issue guarantees under this Title. The Board, whose decisions are to be made by majority vote, is composed of the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve System, the Chairman of the Board of Governors of the Federal Reserve System, the Chairman of the Board of Governors of the Federal Reserve System, the Chairman of the Board of Governors of the Federal Reserve System, and the Chairman of the Board of Governors of the Federal Reserve System.

§ 103. Authority for guarantees
This section authorizes full or partial guarantees of State obligations, and requires that where the Board denies an application, it must state its reasons in writing to the Governor of the State concerned and to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Banking, Currency, and Housing of the House of Representatives.
Section 105 refers to the rule of construction set forth in section 101(4) in order to make clear the intention that obligations of a State agency or instrumentality may be guaranteed by the Board if the purpose of the State law creating it was to provide a mechanism to deal with the fiscal problems of a municipality.

§ 105. Purpose.

Guarantees may be made for either of two purposes. One is to enable the municipality to continue to provide essential public services and facilities. The other is to prevent or mitigate the effects of a default which has not, or which can reasonably be expected to have, a serious adverse effect on general economic conditions or on the marketability of tax-exempt securities in general.

From the testimony received, your Committee has concluded that the present fiscal situation of New York City is sufficiently serious to meet either criterion. Without some sort of Federal aid, it seems doubtful that the City can maintain essential services and facilities through the coming winter. The suggestion that the City could tap the private market through the issuance of certificates of indebtedness under the auspices of a bankruptcy court seems to be based on little more than wishful thinking. Once private investors have been put through the trauma of an actual default, the likelihood is remote that they can be induced to supply voluntarily on a nonguaranteed basis the very substantial financing needs of the City over the next several months, much less the next several years. Only a demonstrated capacity to repay obligations when due is likely to reopen the private market, and only a Federal guarantee can afford the City the opportunity to carry out that demonstration.

§ 105. Conditions of eligibility.

Subsection (a) of this section requires (1) that the credit markets be closed to both the City and State involved, (2) the submission of a detailed financial plan for fiscal solvency, (3) the creation of State receivership, and (4) the provision of additional aid by the State to the City to the extent required by the Board not exceeding one-third of the municipality’s deficit. In a postdefault or bankruptcy situation, where there may be a serious erosion in the City’s revenue, the Board would be empowered under subsection (b) to waive one or more of the foregoing conditions.

It is the intention of section 105(a)(1) to create a test of practical unavailability of credit to both the City in question and the State of which it is a part before the Federal guarantee can be made available. For example, if the application for a guarantee were made by a State agency which had exhausted its credit, but it were feasible for a different State agency, or the State itself, to obtain credit adequate in amount for the needs of the municipality, it would clearly be incumbent upon the Board to deny the application.

In the same vein, it should be noted that while section 105(a)(2) literally speaks only of the assisted municipality submitting “a plan for bringing its operating expenses into balance with its recurring revenues”, the Board, in assessing the soundness of the plan, clearly must take into consideration both capital investment requirements and the capacity of the municipality to retire its long-term bonded indebtedness at a reasonable rate.
Section 105(a)(3) requires the applicant State to demonstrate that it has the authority to control the fiscal affairs of the assisted municipality for the entire period during which the Federal guarantee will be outstanding including the authority to determine all revenue estimates, set aggregate expenditure limits, disapprove all expenditures not in compliance with the plan, and approve all borrowing and contracts during that period.

In the case of New York City, this test has been met by the establishment under State law of the Emergency Financial Control Board.

Section 105(a)(4) authorizes the Board to require the applicant State to assist the municipality to the extent of one third of its anticipated operating deficit. Obviously, the special assistance contemplated under this paragraph would not extend beyond the end of the second fiscal year after the application for assistance, because by that time the municipality must have a balanced budget in order to meet the requirements of section 105(a)(2).

The provisions of section 105(b), which permit the Board to waive the requirements set forth in section 105(a) above in the case of a political subdivision which has filed a petition under the Bankruptcy Act, or which is actually defaulted on one or more of its obligations seem absolutely essential. This is because one of the consequences of either of these actions would be a substantial erosion in the City's revenues. Substantial creditors of the City who were also debtors to the City would be forced to withhold payments to the City in order to protect their own position.

\section{106. Guarantee fees.}

This provides for a guarantee fee not exceeding three quarters of one percent per annum. Within this limitation, the actual amount of the guarantee fee is left to the discretion of the Board. Under circumstances of extreme hardship such as might exist in a postdefault situation where Federal aid had been withheld until the erosion of revenues and other costly and destructive effects of default were well underway, the Board might wish to consider imposing a substantially reduced or nominal guarantee fee in order to avoid compounding the disaster.

\section{107. Limitations on amount of guarantees outstanding.}

This section limits the amount of outstanding guarantees of long term securities to $8 billion in the period from date of enactment to 1950, and to $3 billion from then until 1999. The dates and amounts provided in this section set forth the outer limits which your Committee believes should be provided in order to enable the Federal Government to deal prudently with a postdefault situation in which the uninsured private market would be effectively closed to the City for an indeterminable but substantial period of time. They are intended for use under a financial plan which contemplates full payout without resort to refunding. To enable the City to get through the immediate postdefault period, there is authority for the guarantee of up to $2 billion in short-term obligations prior to October 1, 1978.

Section 107(c) sets an outer limit of September 30, 1999 for the fiscal maturity of any guaranteed obligation.
§ 108. Obligations callable after three years.

Because of the interplay between this section and the other provisions of the bill, it seems unlikely that any Federal guarantee will remain in effect for the full period allowed in section 107, even if some are initially issued for that period. If there is a substantial failure to carry out the plan for a balanced budget which is required to be submitted to and approved by the Board under section 104(a)(2), then there will almost certainly be a call on the Federal Government to make good on the guarantee. Shortening the permissible guarantee period would not help to avoid this result, and may tend to make it more probable by biasing the financial plan in an overly optimistic direction. On the other hand, if the plan is in fact carried out for a substantial time and the City re-establishes a history of meeting its obligations when due, it seems reasonable to anticipate that the private tax-exempt market will reopen to it. At that time, it should be financially advantageous to the city to refund its taxable guaranteed obligations with nonguaranteed tax-exempt securities, and if this is done, the Federal Government would thereby be relieved of its contingent liabilities under the guarantees.

The only circumstances under which the guarantees would remain in effect for the full period under section 107 would be those under which the City somehow managed to meet all of its obligations and yet was never able to engender sufficient confidence in its future ability to do so to reopen the private market. If the city's condition were indeed as tenuous as that, then the requirement of the bill that the State Emergency Financial Control Board and the Federal Intergovernmental Emergency Assistance Board continue to monitor the affairs of the City would seem to be a wise precaution.

§ 109. Additional terms and conditions.

This section requires the Board to insist that outstanding obligations be renegotiated as a prerequisite to the Federal guarantee. For holders of debt instruments, this means an exchange of the paper which they hold for new unguaranteed paper bearing a substantially longer maturity, a substantially lower interest rate, or both. In the specific case of New York City, it is your Committee's intention that such renegotiation extend to a substantial portion of the M.A.C. obligations now outstanding, and to a significant portion of other City obligations, maturing before June 30, 1976.

Where such negotiation involves the term of contracts of other provisions for compensation (including pensions and other benefits) for personal services rendered or to be rendered, there may be taken under consideration the compensation and other benefits provided for similar services by other employers, with particular reference to employers which are political subdivisions of the same State or of other States.

Finally, this section authorizes the Board to insist on any other terms and conditions not inconsistent with the general purposes of the Act.

§ 110. Audits.

This section authorizes audits by the General Accounting Office or at its own initiative or at the request of the Board. Such audits
may be used not only of the municipality directly, but any other agency or instrumentality of the State or municipality that either the Board or the General Accounting Office feels should be audited. Under authority of a similar provision in the Emergency Loan Guarantee Act (15 U.S.C. 1896(b)), the General Accounting Office has made executive use of audits made by an independent auditing firm, subjecting those to such checks for completeness and accuracy as it deemed appropriate. Under the legislation herewith reported, your Committee would expect the General Accounting Office to make use of State and any other available audits, but to continue to exercise its own critical and independent judgment as to their adequacy, and to make audits of its own wherever necessary.

Your Committee takes note of allegations, by the Office of the State Comptroller and others, that the present and past management of New York City have gravely misrepresented the finances of the City, by hiding expense items in the capital budget, by issuing tax and revenue anticipation notes against income which would not be forthcoming, and otherwise. Section 110 is designed to ensure that such gimmickry cannot and will not continue.

§ III. Emergency Municipal Debt Guarantee Fund.

The fund created by this section would be the receptacle for guarantee fees imposed under section 106, and would be the source for the Board's administrative expenses as well as any payments which might be required to fulfill the Board's obligations. Should there be insufficient moneys in the fund to make such payments, the Secretary of the Treasury would be required to make them on behalf of the Board, and for that purpose would be authorized to use as a public debt transaction proceeds from the sale of direct obligations of the United States.

§ 112. Federal Reserve banks as fiscal agents.

This section requires Federal Reserve banks to act as fiscal agents of the Board at its request. A similar provision in the Emergency Loan Guarantee Act (15 U.S.C. 1899) appears to have been construed broadly in terms of the range of services which the Board may obtain under it.

§ 113. Protection of Government's interest.

This section authorizes legal action by the Attorney General to enforce any rights accruing to the Government as a result of the issuance of guarantees, and provides that the Government would be subrogated to the rights of any creditor whose claim was satisfied pursuant to the guarantee. It also reserves to the United States the right to offset against any sums owing to a State or political subdivision for whose benefit any guarantee is made under this title, the amount in whole or part of any payment actually made by the United States pursuant to any such claim. Discretion is vested in the Board as to the manner and extent that this right of offset would be exercised, because it is clear that the right of offset might arise under circumstances where its immediate and substantial exercise would only exacerbate the problems and increase the expenses of the Federal Government as a whole.
Finally, this section authorizes the Board to increase the guarantee fee (up to a maximum rate of 3.25 percent per annum) whenever there is a failure of the political subdivision or the obligor of any securities issued for its benefit to fulfill any commitment or undertaking which it agreed to fulfill in consideration of the issuance of the guarantee by the Board. The purpose of this provision is to give the Board a means to bring about the correction of shortcomings before they become critical.

§ 714. Reports.

The Board is required to make quarterly reports to the Congress of its operations under this Title.

§ 725. Termination.

The Board’s authority to make guarantees terminates on September 30, 1979. This would not, of course, affect the continuing validity of any guarantee entered into prior to that date, nor does it affect the Board’s rights and remedies to enforce compliance with conditions attached to its guarantees.

TITLE II - AMENDMENT TO INTERNAL REVENUE CODE OF 1954

§ 2901. Taxability of certain federally guaranteed obligations.

This section amends section 163(a)(1) of the Internal Revenue Code of 1954 to provide that interest on obligations guaranteed under Title I would be subject to Federal income taxation. The exclusion from gross income which the Revenue Code provides for interest on State obligations is not subject to waiver by the issuer of such obligations, and in the absence of this section of the bill, or some other provision having the same legal effect, it would be impossible for the State to comply with the condition set forth in Title I that guaranteed obligations must be taxable.

COMMITTEE VOTE

On November 3, 1975, your Committee ordered H.R. 10181 favorably reported by a roll call vote in which 23 votes were cast in favor of, and 16 votes were cast against, the motion to report the bill.

ESTIMATE OF COSTS

In compliance with Clause 7 of Rule XIII of the Rules of the House of Representatives, there is set forth below an estimate of costs which would be incurred in carrying out H.R. 10181 in the current fiscal year and for each of the subsequent five fiscal years.

ADMINISTRATIVE COSTS

On the basis of experience with somewhat similar activities carried out by the Emergency Loan Guarantee Board and the General Accounting Office under the Emergency Loan Guarantee Act, the costs of which have ranged between about $30,000 and $143,000 per year, your Committee estimates that the administrative costs involved in the implementation of the bill hereafter reported would be less than $1 million per year.