TO: Messrs. Carswell, Mundheim, Altman, Taylor, Heliak, Lynch and Kress

FROM: John Pouhey

DATE: JUN 1 1978

SUBJECT: Seasonal Financing Bills

Representative Stanton has introduced a bill (H.R. 12502) that would limit further Federal financing assistance for New York City to a three-year extension of the existing seasonal lending authority. Maximum lending authority would decline over the three-year period, as follows:

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<thead>
<tr>
<th>Fiscal Year</th>
<th>Maximum Lending Authority</th>
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<tbody>
<tr>
<td>1979</td>
<td>$2,000,000,000</td>
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<tr>
<td>1980</td>
<td>1,500,000,000</td>
</tr>
<tr>
<td>1981</td>
<td>800,000,000</td>
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</table>

The Stanton bill is structured as an amendment to the Seasonal Financing Act of 1975, and the amendments are limited to those necessary to reflect the new lending authority -- no conditions are proposed to be added beyond the sole present condition of "reasonable prospect of repayment".

The Stanton bill may be unsatisfactory for a number of reasons:

1. It authorizes seasonal lending for a three-year, not four-year, period.

2. The levels of lending authority may be inadequate.

3. In the aftermath of the Moorhead and Treasury loan guarantee bills, which contained numerous conditions that had to be met before guarantees could be issued, it may be difficult to obtain even seasonal lending authority without specifying conditions in the statute.

4. There may be changes that Treasury would like made in the Seasonal Financing Act, such as inclusion of authority...
to withhold transfer payments to recoup loans and to waive the priority afforded the United States, as creditor, by 31 U.S.C. § 191.

Therefore, I have drafted a bill amending the Seasonal Financing Act that addresses those problems:

1. Section 5 provides for a four-year extension of seasonal lending authority, with amounts left blank for completion by Messrs. Altman and Taylor.

2. Section 4 deals with conditions that must be satisfied before a loan may be made, including a rolling four-year financial plan. (The definition added by section 1 is necessary for one of the conditions.)

3. Section 3, taking language almost verbatim from Treasury's loan guarantee bill, specifies that the Secretary shall withhold transfer payments if necessary to obtain repayment (the present law would not permit withholding without further legislation) and also authorizes a waiver under 31 U.S.C. § 191. Section 2 would permit seasonal loans to MAC; the City could not meet the "joint and several liability" condition in the present law.

Section 6 and 7 make certain necessary mechanical changes; I may have a further change (comparable to section 2(a) of the Stanton bill) after checking the language of the appropriation act passed to fund loans under the Seasonal Financing Act.

At the risk of stating the obvious, I should emphasize that, since the draft addresses a number of distinct problems, sections of it can be chosen at will for an actual bill, depending on our judgment as to what is necessary or desirable.

In addition to a copy of my draft, copies of the Stanton bill and the Seasonal Financing Act of 1975 are attached.

Attachments
Bill Amending P.L. 94-143
(New York City Seasonal Financing Act of 1975)
to Provide Seasonal Financing through June 30, 1982

Section 1. Section 3 of the New York City Seasonal Financing Act of 1975 is amended by adding at the end thereof the following new definition:

"(d) 'independent fiscal monitor' means an instrumentality of the State that has the authority and has been directed to regulate the fiscal affairs of the City, including authority and direction to require the City to adopt and adhere to financial plans meeting the requirements of section 6(a)(2), for at least the period during which loans may be made under this Act, which authority and direction the State has covenanted will not be repealed, invalidated or otherwise substantially impaired during such period."

Section 2. Section 4(a) of the New York City Seasonal Financing Act of 1975 is amended by striking "the City and such agent shall be jointly and severally liable thereon." and inserting in lieu thereof "only if the proceeds of such loan are advanced to or applied for the benefit of the City."

Section 3. Section 5 of the New York City Seasonal Financing Act of 1975 is amended by striking out the third
and fourth sentence and inserting in lieu there the following:

"Any other provision of law to the contrary notwithstanding, the Secretary shall withhold from any payments from the United States to the City or the State of the character described in clauses (i), (ii), and (iii) of this section 5 that may become due pursuant to any law, and shall, in the case of payments of the character described in clauses (i) and (ii), deposit in the general fund of the Treasury, an amount, calculated on the date such payment is otherwise payable, equal to the aggregate of all outstanding claims that the Secretary has against the City or any financing agent pursuant to this Act. The Secretary shall withhold from such payments in the following order of priority:

"(i) First, payments to the City under the State and Local Fiscal Assistance Act of 1972, as presently or in the future amended, or any other enactment providing for general purpose financial assistance;

"(ii) Second, payments to the State under the State and Local Fiscal Assistance Act of 1972, as presently or in the future amended, or any other enactment providing for general purpose financial assistance: Provided, That the Secretary shall not withhold any amount from any payment to the State to
the extent he reasonably expects that within the next ninety days a payment of an equal or greater amount subject to withholding under clause (i) of this section 5 will be payable to the City; and

"(iii) Third, any other payments to the City.

With respect to any debts to the United States arising under this Act, for the purposes of section 3466 of the Revised Statutes (31 U.S.C. 191), the term "person" includes the City or any financing agent. The provisions of such section to the contrary notwithstanding, the Secretary is authorized to waive, wholly or partially, the priority for the United States established thereunder with respect to any indebtedness for borrowed money of the City or any financing agent issued after the effective date of this Act (other than any indebtedness that is a refunding of indebtedness outstanding on or before such date prior to the stated maturity thereof) if, in his judgment, such waiver is necessary to facilitate the ability of the City to meet its financing needs: Provided, That no such waiver by its terms shall subordinate the claims of the United States to those of any other creditor of the City or any financing agent."
Section 4. Section 6(a) of the New York City Seasonal Financing Act of 1975 is amended by striking all of the text of such section and inserting in lieu thereof the following:

"A loan may be made under this Act only if

(1) the Secretary determines that there is a reasonable prospect of repayment of the loan in accordance with its terms and conditions;

(2) the City has submitted to the Secretary a plan, approved by the independent fiscal monitor and covering the fiscal year in which such loan is to be made and the three next succeeding fiscal years, setting forth projections of the revenues, expenses and capital expenditures of the City for each of such fiscal years, the results of which projections of revenues and expenses would, for fiscal years of the City beginning after June 30, 1981, not show a deficit when reported in accordance with generally accepted accounting principles applicable to governmental bodies and would, for fiscal years of the City beginning on or prior thereto but after June 30, 1978, demonstrate substantial progress towards that goal;"
"(3) the Secretary determines that credit is not otherwise available to the City or a financing agent on reasonable terms; and

"(4) the City has agreed to obtain and submit to the Secretary, as soon as practicable after the close of each fiscal year of the City during which loans may be made hereunder, an opinion of independent public accountants setting forth the results of an audit by such accountants of the financial statements of the City for such fiscal year.

The Secretary is authorized to determine the manner in which such loans will be made and, in addition to the terms and conditions required by this section 6(a), to require from, or agree to with, the City, a financing agent or any other party in interest such other terms and conditions as he may deem appropriate, including provision of security for the repayment of such loans. Any such other term or condition may be modified, amended or waived in the discretion of the Secretary."

Section 5. Section 6(b) of the New York City Seasonal Financing Act of 1975 is amended by inserting "(1)" immediately after "(b)" and by striking out "$2,300,000,000" and inserting in lieu thereof "$2,300,000,000 during the period ending June 30, 1978." and by adding at the end thereof the following new paragraphs:
"(2) At no time during the period from July 1, 1978 through June 30, 1979 shall the amount of loans outstanding under this Act exceed in the aggregate $ ____________.

"(3) At no time during the period from July 1, 1979 through June 30, 1980 shall the amount of loans outstanding under this Act exceed in the aggregate $ ____________.

"(4) At no time during the period from July 1, 1980 through June 30, 1981 shall the amount of loans outstanding under this Act exceed in the aggregate $ ____________.

"(5) At no time during the period from July 1, 1981 through June 30, 1982 shall the amount of loans outstanding under this Act exceed in the aggregate $ ____________.

Section 6. Section 8(a) of the New York City Seasonal Financing Act of 1975 is amended by striking out the sentence and inserting the following: "During any period specified in section 6(a) any moneys in the fund in excess of the amount of loans that can be outstanding during that period shall be returned to the general fund of the Treasury, and any moneys in the fund after June 30, 1982 shall be returned to the general fund of the Treasury."

Section 7. Section 11 of the New York City Seasonal Financing Act of 1975 is amended by striking out "1978" and inserting in lieu thereof "1982".
H. R. 12502

IN THE HOUSE OF REPRESENTATIVES

MAY 2, 1978

Mr. STANTON introduced the following bill; which was referred to the Committee on Banking, Finance and Urban Affairs

A BILL

To extend the authority of the Secretary of the Treasury to make loans under the New York City Seasonal Financing Act of 1975 for a period of three years.

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

SECTION 1. Section 6 (b) of the New York City Seasonal Financing Act of 1975 is amended by inserting "(1)"
immediately after "(b)" and by striking out "$2,300,000,000." and inserting in lieu thereof "$2,300,000,000
for the period ending June 30, 1978."

(2) At no time during the period from July 1, 1978, to
June 30, 1979, shall the amount of loans outstanding under this Act exceed in the aggregate $2,000,000,000.

“(3) At no time during the period from July 1, 1979, to June 30, 1980, shall the amount of loans outstanding under this Act exceed in the aggregate $1,500,000,000.

“(4) At no time during the period from July 1, 1980, to June 30, 1981, shall the amount of loans outstanding under this Act exceed in the aggregate $800,000,000.”.

Sec. 2. (a) The third sentence of section 8 (a) of the New York City Seasonal Financing Act of 1975 is amended by striking out “$2,300,000,000.” and inserting in lieu thereof: “$2,300,000,000 for the period ending June 30, 1978, and $2,000,000,000 for the period beginning July 1, 1978 and ending June 30, 1981.”.

(b) The sixth sentence of such section 8 (a) is amended by inserting before the period at the end thereof the following: “, except that moneys in the fund in excess of the maximum needed to meet the requirements of section 6 (b) shall be returned to the general fund of the Treasury following the periods specified in sections 6 (b) (2) and (3)”.

Sec. 3. Section 11 of the New York City Seasonal Financing Act of 1975 is amended by striking out “1978” and inserting in lieu thereof “1981”,
A BILL

To extend the authority of the Secretary of the Treasury to make loans under the New York City Seasonal Financing Act of 1973 for a period of three years.

By Mr. Stastny

Referred to the Committee on Banking, Finance and Urban Affairs

Mar. 2, 1978
Public Law 94-143  
94th Congress, H. R. 10481  
December 9, 1975

An Act

To authorize the Secretary of the Treasury to provide seasonal financing for the city of New York.

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

SHORT TITLE

SECTION 1. This Act may be cited as the “New York City Seasonal Financing Act of 1975”.

FINDINGS AND DECLARATIONS

Sec. 2. The Congress makes the following findings and declarations: 31 USC 1501

(1) It is necessary for the city of New York to obtain seasonal financing from time to time because the city’s revenues and expenditures, even when in balance on an annual basis, are not received and disbursed at equivalent rates throughout the year.

(2) At the present time the city is or may be unable to obtain such seasonal financing from its customary sources.

(3) It is necessary to assure such seasonal financing, in order that the city of New York may maintain essential governmental services.

DEFINITIONS

Sec. 3. As used in this Act: 31 USC 1502

(a) “City” and “State” mean the city and State of New York, respectively.

(b) “Financing agent” means any agency duly authorized by State law to act on behalf or in the interest of the city with respect to the city’s financial affairs.

(c) “Secretary” means the Secretary of the Treasury.

LOANS

Sec. 4. (a) Upon written request of the city or a financing agent, the Secretary may make loans to the city or such financing agent subject to the provisions of this Act, but in the case of any loan to a financing agent, the city and such agent shall be jointly and severally liable thereon.

(b) Each such loan shall mature not later than the last day of the city’s fiscal year in which it was made, and shall bear interest at an annual rate 1 per centum per annum greater than the current average market yield on outstanding marketable obligations of the United States with remaining periods to maturity comparable to the maturities of such loan, as determined by the Secretary at the time of the loan.

SECURITY FOR LOANS

Sec. 5. In connection with any loan under this Act, the Secretary may require the city and any financing agent and, where he deems necessary, the State, to provide such security as he deems appropriate.

39 STAT. 797
The Secretary may take such steps as he deems necessary to realize upon any collateral in which the United States has a security interest pursuant to this section to enforce any claim the United States may have against the city or any financing agent pursuant to this Act. Notwithstanding any other provision of law, Acts making appropriations may provide for the withholding of any payments from the United States to the city, either directly or through the State, which may be or may become due pursuant to any law and offset the amount of such withheld payments against any claim the Secretary may have against the city or any financing agent pursuant to this Act. With respect to debts incurred pursuant to this Act, for the purposes of section 3466 of the Revised Statutes (31 U.S.C. 101) the term “person” includes the city or any financing agent.

LIMITATIONS AND CRITERIA

31 USC 1505.

Sec. 6. (a) A loan may be made under this Act only if the Secretary determines that there is a reasonable prospect of repayment of the loan in accordance with its terms and conditions. In making the loan, the Secretary may require such terms and conditions as he may deem appropriate to insure repayment. The Secretary is authorized to agree to any modification, amendment, or waiver of any such term or condition as he deems desirable to protect the interests of the United States.

(b) At no time shall the amount of loans outstanding under this Act exceed in the aggregate $2,500,000,000.

(c) No loan shall be provided under this Act unless (1) the city and all financing agents shall have repaid according to their terms all prior loans under this Act which have matured, and (2) the city and all financing agents shall be in compliance with the terms of any such outstanding loans.

REMEDIES

31 USC 1506.

Sec. 7. The remedies of the Secretary prescribed in this Act shall be cumulative and not in limitation of or substitution for any other remedies available to the Secretary or the United States.

FUNDING

New York
City Seasonal
Financing
Fund.
Establishment.
31 USC 1507.
Appropriation
authorization.

Sec. 8. (a) There is hereby established in the Treasury a New York City Seasonal Financing Fund to be administered by the Secretary. The fund shall be used for the purpose of making loans pursuant to this Act. There is authorized to be appropriated to such fund the sum of $2,500,000,000. All funds received by the Secretary in the payment of principal of any loan made under this Act shall be paid into the fund. All income from loans and investments made from the fund shall be covered into the Treasury as miscellaneous receipts. 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. After all loans made pursuant to this Act have been repaid, the balance of the fund shall be returned to the general fund of the Treasury.

(b) The Secretary is authorized to sell, assign, or otherwise transfer from the fund any note or other evidence of any loan made pursuant to this Act or the Federal Financing Bank and, in addition to its other powers, such Bank is authorized to purchase, receive, or otherwise acquire the same.

89 STAT. 798
December 9, 1975 - Pub. Law 94-143

Appropriation authorization.

There are authorized to be appropriated such sums as may be necessary to pay the expenses of administration of this Act.

INSPECTION OF DOCUMENTS

Sec. 9. At any time a request for a loan is pending or a loan is outstanding under this Act, the Secretary is authorized to inspect and copy all accounts, books, records, memorandums, correspondence, and other documents of the city or any financing agent relating to its financial affairs.

AUDITS

Sec. 10. (a) No loan may be made under this Act for the benefit of any State or city unless the General Accounting Office is authorized to make such audits as may be deemed appropriate by either the Secretary or the General Accounting Office of all accounts, books, records, and transactions of the State, the political subdivision, if any, involved, and any agency or instrumentality of such State or political subdivision. The General Accounting Office shall report the results of any such audit to the Secretary and to the Congress.

TERMINATION

Sec. 11. The authority of the Secretary to make any loan under this Act terminates on June 30, 1978. Such termination does not affect the carrying out of any transaction entered into pursuant to this Act prior to that date, or the taking of any action necessary to preserve or protect the interests of the United States arising out of any loan under this Act.

Approved December 9, 1975.

LEGISLATIVE HISTORY:

HOUSE REPORTS: No. 94-632 Pt. 1 (Comm. on Banking, Currency and Housing), Pt. 2 (Comm. on Ways and Means).

SENATE REPORT No. 94-443 (Comm. on Banking, Housing and Urban


Dec. 3-5, considered and passed Senate.

89 STAT. 799
JAN 1 1978

Honorable Daniel P. Moynihan
United States Senate
Washington, D.C. 20510

Dear Senator Moynihan:

Thank you for your recent letter pertaining to data in the Federal Outlays Report.

The report is produced by us under OMB policy guidance. My staff has had several meetings with them to discuss recommendations for improvement of the data. A part of the problem is the assumption that "Federal Outlays" can be translated as conveying Federal benefit to the area receiving it. The name of the report will be changed to the "Geographic Distribution of Federal Funds" to emphasize that the report reflects where checks are mailed, not necessarily where the ultimate beneficiary is located.

To address your specific concern about the reporting of funds entitled "Interest on the Public Debt" and "Foreign Economic and Financial Assistance", OMB has agreed with us to move these programs (and others in a like category) from the "Federal Funds" section of the report to the "Indirect Federal Support" section. Although "Indirect Federal Support" programs are listed, they are not totaled by State, county or city. Accordingly, the caveat pertaining to "Indirect Federal Support" will be modified to include information on these programs.

We welcome any further suggestions or recommendations you might have for further improving the report.

Sincerely,

[Signature]

Graciela (Grace) Olivarez
Director
STATEMENT BY SENATOR DANIEL PATRICK MOYNIHAN (D., N.Y.)

There is a rule of sorts in government that nothing ever gets done about a problem until someone learns how to measure it.

I believe we have now taken the first step toward measuring the sharp imbalance between the taxes paid by New York to the Federal government and the Federal outlays which New York receives in return.

The Federal government has been overstating its outlays by some $14 billion. Mrs. Olivarez' letter (attached) puts an end to this, and now for the first time we have a measure of the true deficit which New York, far more than any other State, has in its balance of exchange with Washington.

I must express my appreciation to President Carter. I brought this issue to his attention last June. He set the Administration to work on the question in a careful and orderly way. We now have our answer. It fullyjustifies our original intention, and it also justifies our belief that we would receive a fair-minded and scrupulous hearing from the Administration.

I dare to suggest that this development puts New York City's fiscal crisis in a wholly new light.
REDUCTIONS IN REPORTED FEDERAL OUTLAYS (1976)
BY REMOVING "INTEREST ON THE PUBLIC DEBT" AND "FOREIGN ECONOMIC AND
FINANCIAL ASSISTANCE"

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Memorandum

January 5, 1978

TO: Felix Rohatyn, Donald D. Kummerfeld
FROM: Robert H. Wood
SUBJECT: Response of Senator Moynihan to Proxmire and Brooke Letter

We would appreciate your views on the attached response of Senator Moynihan to the letter sent by Senators Proxmire and Brooke to President Carter on the subject of further Federal assistance for New York City.

cc: John Bender
    Eugene Keilin
For Immediate Release

Wednesday, P.M.
January 4, 1978

Contact: Tim Russert
202/224-4451

Senator Daniel Patrick Moynihan (D., N.Y.) today sent the attached letter to President Carter in response to the December 23, 1977 letter of Senators Proxmire and Brooke concerning the Federal seasonal loan program to New York City.

-30-
United States Senate  
WASHINGTON, D.C. 20510

January 4, 1978

Dear Mr. President:

As the contents of the letter which Senators Proxmire and Brooke have sent to you concerning the renewal of the Federal seasonal loan program to the City of New York have now been generally reported in the press, I will take the liberty of offering some further comments of my own. Senator Proxmire, with characteristic grace, invited me to participate in the Banking Committee hearings, and hence, I have some sense of the occasion. It is in any event a subject which I follow with close attention.

Let me first express the hope that you will receive the letter from Senators Proxmire and Brooke in the spirit in which it was sent. It is a thoughtful and fair-minded statement which addresses itself to the first question the Congress must ask, which is whether this program should be renewed. There is no automatic presumption to this effect, and indeed the City and State officials who requested the program three years ago were rather of the view that three years would do the job.

It didn't. There is even a sense in which our situation today in New York City is more perilous than it was then, for a great expenditure of energy and attention has occurred and there is now both a measure of weariness with it all, and an understandable assumption by many that much of the problem has been taken care of. In these circumstances the Senators are entirely within their rights, or so I believe, to point out that much more remains to be done, and that most of this must be done by the City and State itself.

I cannot, however, share their hope that in the end it will not be necessary to renew the seasonal loan program. It will be. You know this, and if you have
doubts you need only consult the Treasury Department. It is simply the fact that until some long term re-financing is arranged, the City will need Federal loans.

This is no great affair. The loans don't cost a penny; in point of fact, the Federal government makes money from them. The Treasury charges the City a one percent surcharge over and above the rate at which it borrows the money it then proceeds to lend. I gather the Treasury has so far earned some $30 million in this way. The loans have been faithfully repaid, on time and in full. When the program is extended, they will continue to be faithfully repaid.

My concern is that we seem now to have commenced a six month melodrama which will end in a dramatic rescue, great relief, and no little mutual congratulation all round. When it is over the Federal government will have judged that the needs of the City of New York have been met for this Congress and that will be that. When in fact nothing will have changed; nothing will have been achieved.

With this concern in mind, allow me to put to you a proposition which may at first seem outlandish, but which on reflection will be seen to be, or so I believe, self-evident.

The proposition is as follows. The single object of urban policy in the United States in the years immediately ahead must be to prevent the bankruptcy of New York City.

The instincts protest, of course. For one thing, the very idea that New York City could go bankrupt is still not fixed very firmly in our imagination. In any event, two centuries of Madisonian politics has fixed in our minds the notion that public resources must be widely distributed among competing interests, and will be regardless of what anyone might wish.

However, on reflection, as I believe, it will be seen that not only is the collapse of the City's finances a real possibility, but the consequences of such a collapse would be such as to obviate the lessons of two centuries of Federalism, howsoever successful the system may have been until now.
The bankruptcy of New York would be the Lisbon earthquake of the urban civilization which took form in the course of the industrial revolution. This world would never again seem quite as hopeful, never again quite as safe. The fragility of all our arrangements would be brought into question as no comparable event could do.

For there is no comparable city. When the French historian Fernand Braudel was trying to explain the importance of Venice to the Mediterranean world of the 15th or 16th Century he wrote: "Venice dominated the 'Interior Sea' as New York dominates the western world today."

New York is the capital city of the Western world. That is why the United Nations is there. That is why it is the center of the financial system of the western world. That is why, as Mayor Koch noted in his inaugural address, more books are published in New York than in any city in the world. That is why more languages are spoken in New York than any city in the world, why there are more newspapers published there in what by a curious custom we call "foreign" languages than in any city of the world.

More, New York has also served from the beginning of the Republic in the role of a capital city for the nation. It has seemed to me that of all the separations of power provided for in the American Constitution, perhaps the most important of all is the one that is in a sense extra-constitutional, although commenced and continued in a truly constitutional spirit. When Hamilton and Jefferson struck the agreement over madeira in a tavern on Broad Street they had more in mind than dividing the spoils of office. They agreed that the political capital should move from New York to what would become Washington, a city that then did not exist. They also agreed all the other purposes of the first city of the nation would be served by New York, as they then were. Hence the dreaded merger of political power with financial power, of the culture with the government would be avoided in the American Republic. And so they have been, through most of two long centuries. But now that division is threatened. Already, as the Senators note, the Federal government is involved in the very interstices of life in the City. It has fallen to us -- all of us -- to reverse this process and to restore that separation of power which has meant so much.
I will dare to suggest that this realization, however inarticulated or even semi-conscious, is at the root of the difficulties the administration seems to have in formulating a national urban policy. The fact is that most of the urban programs of the Federal government over the past thirty years have deepened the dependency of cities such as New York on the Federal government, whilst astonishing Federal tax burdens have been imposed on the city in order to pay for the programs that increase its dependency. Hence with the best will in the world the urban planners of your administration cannot bring themselves to believe that doubling or trebling the same old programs will make things better. They know it would make things worse. Predictably, they are now being forced in the direction of job creation. But barring a breakthrough in the precepts of political economy equivalent to The Wealth of Nations, the job creation programs you will propose in March will only deepen the dependency of the cities still further.

I have not been overmuch impressed with the talk to be heard in New York itself to the effect that our circumstances are not qualitatively different from those of other cities, and that whatever troubles we have today, everyone will have tomorrow. This is autotherapeutic nonsense. The problems of New York are uniquely those of a capital. It is in no worse shape today than London or Paris would be if the national government paid them no more attention. However, all the cities in the nation will grow more dependent as the unintended effects of national urban policy take their toll.

If you wish to reverse this, you will have to fight against it. You will, for example, have to be the first President to acknowledge what political scientists have known for some time, which is that the public professions of the country have created powerful vertical connections from the bottom of the Federal system through every successive layer up to the top which constantly reinforce one another. Thus the welfare bureaucracy in New York City tells the welfare bureaucracy in Albany that it must persuade the welfare bureaucracy in Washington to order the welfare bureaucracy in New York to do precisely what the welfare bureaucracy in New York wants to do -- and somehow these signals always get through.
But most importantly, it will, if I am correct, be necessary to come to terms with the question of restoring the health of the private economy of New York City on which the well-being of the public sector depends.

The first fact is that of employment.

New York is the only state in the Union which has not come back to the peak levels of employment reached in 1973, prior to the last recession.

But not only has New York not recovered from that recession. It has not recovered from the recession of 1969. I attach a table showing these numbers. Since 1969 the private sector of the economy of New York State has lost 420,000 jobs. Public sector employment has gone up, but not public sector Federal employment. Since 1967 the number of Federal jobs in New York City alone has decreased by 24,400.

In the meantime Federal taxes collected in the City have gone up and up. Federal decisions such as the one you recently made to double the number of "trans-Atlantic gateways" in aviation helps some cities but hurts New York, whose Pan American is the only private international airway in the world prohibited to fly within the United States. To add insult to what increasingly seems like injury, the Federal government misrepresents the flow of funds between the state and the nation, or so I contend. In the Federal Outlays series New York is credited with receiving 49 percent of the Interest on the Public Debt, some $14 billion per year. This is broken down on a per capita basis, such that the Federal government solemnly informs us that each citizen of the state received in 1976 $737.73 from the Treasury Department as interest on his or her Federal Securities.

As you know -- for you have been most generous in hearing me out in this matter -- I have argued that if the State of New York had received back from the Federal government the average rate of return for all states in 1976 it would have got $13 billion more in Federal outlays than it did. If it had received the "rate of return" of California it would have received $32 billion more than it did. Given such sums, New York City's debt of $14 billion does not seem quite so inexplicable.
And so it comes to this. The national government must provide New York the resources -- the relief -- it needs to become solvent again. It will not be enough for this merely to be an aspect of national urban policy. For the immediate future it must be the essence of urban policy.

For if New York City goes bankrupt, nothing else will be noted, nothing else will be remembered. I repeat my comparison with the Lisbon earthquake. It would change the culture. It would be the only thing this Congress and your administration would be remembered for.

As you know, I have the uttermost confidence in your commitment in this matter. In the splendid interview you gave to Ken Auletta in the September 13, 1976 issue of New York magazine you stated directly that you would ask Congress to stretch the federal loan program beyond the current three years, while after the election on December 28, 1976 you stated most emphatically that, "Bankruptcy is not a viable alternative for New York City and we have eliminated that as a possibility for the future." It would be helpful, I believe, if you were to reconfirm these positions at an early date. But further, I do hope you will share my view that nothing is to be gained by pretending that the renewal of the loan program constitutes a weighty issue of public policy, nor yet that when it has been done the needs of New York City will have been attended to in sufficient degree that attention can safely turn elsewhere.

Respectfully,

Daniel Patrick Moynihan

The President
The White House
Washington, D. C.
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Total employment:

- 1969: 7,182.0
- Nov. 1977: 6,869.0
- Job loss: 313.0

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- 1969: 6,006.0
- Nov. 1977: 5,585.5
- Job loss: 420.5

Source: New York State Department of Labor
STATEMENT BY SENATOR DANIEL PATRICK MOYNIHAN (D., N.Y.)

Secretary Blumenthal has called to assure me that press reports that the Treasury Department has asked the City of New York for a financial plan based on the proposals of Senators Proxmire and Brooke are not correct. The Secretary said: "We have never said to the City that they must come up with a plan on the assumption that there will be no federal aid." Secretary Blumenthal added that in his testimony before the Senate Banking Committee he "virtually excluded" the possibility that the City could get by without an extension of the Federal seasonal loan program.

I thank Secretary Blumenthal for his comments. Clearly we can look forward to more than a normal amount of confusion in this matter in the months ahead, but all will come out well enough if corrections are made as soon as mistakes are discovered.

However, given this particular misunderstanding, I believe it would be helpful if the President were to avail himself of an early opportunity to underscore his strong commitment to New York City. As I wrote to the President yesterday:

"As you know, I have the uttermost confidence in your commitment in this matter. In the splendid interview you gave to Ken Auletta in the September 13, 1976, issue of New York magazine you stated directly that you would ask Congress to stretch the federal loan program beyond the current three years, while after the election on December 28, 1976, you stated emphatically that, 'Bankruptcy is not a viable alternative for New York City and we have eliminated that as a possibility for the future.' It would be helpful, I believe, if you were to reconfirm these positions at an early date."

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The White House
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Source: New York State Department of Labor
Mr. David Herships
United States Treasury Department
1325 G Street, N.W. (Room 720)
Washington, D. C. 20005

Dear Mr. Herships:

In accordance with your telephone request today, I am enclosing two copies each of our Preliminary Official Statement of October 29, 1976, our Official Statement of November 5, 1976, our Financial Statements of June 30, 1976, and our Annual Report, which was issued this week.

Sincerely,

[Signature]
Stephan J. Weinstein
Deputy Executive Director

Enclosures (8)

SJW/mp
Mr. Eugene Keilin  
Executive Director  
Municipal Assistance Corporation  
Two World Trade Center  
New York, New York 10047

Dear Mr. Keilin:

As you develop legislative proposals for continued federal assistance to New York City, you may find the enclosed documents helpful. The documents consist of the two bills, plus the reports, which the House and Senate Banking Committees approved in 1975, just before President Ford ended his opposition to any form of New York City aid, and recommended the present seasonal loan program.

The House bill, H.R. 10481, as reported to the House on November 6, 1975, would have created a five man board, composed of the Treasury Secretary, the HUD Secretary, the HEW Secretary, the Chairman of the Federal Reserve, and the Chairman of the SEC. Under the terms of the bill, the board would have the authority to grant federal guarantees of State bonds designed to assist financially pressed cities. The Senate bill would have provided for the same authority, under much the same circumstances and requirements (see below). However, the State would be obliged to meet only one-third, rather than one-half, of the city's operating deficit, and the State could do so by means of a loan, rather than by a grant. The Senate bill would have required the State to meet one-half of the city's deficit by means of a grant.

Rather than the four to five year phase-out planned by the Senate bill, the House bill would authorize $5 billion of outstanding guaranteed bonds until September 30, 1989, and $3 billion thereafter, until September 30, 1999. Moreover, the State would be liable to make up federal losses only to the extent of federal revenues flowing to the State (e.g., revenue sharing funds), rather than reimbursing the federal government in toto for losses.

A mandatory exchange of MAC bonds and city securities would have been authorized by the House bill, but the precise terms and conditions of such an exchange would have been left up to the board. Unlike the Senate bill, the House bill would not have required the voluntary approval of the security holders.

Finally, the Senate bill would have permitted the federally guaranteed bonds to be taxable or non-taxable, depending on the amount of the guarantee fee paid by the State. The House bill would not have permitted a taxable bond option. All interest on guaranteed bonds would have been taxable.
The Senate bill, S. 2615, provided for short term (one year) federally-guaranteed State bonds to finance the credit needs of a city if neither the State nor the city could obtain private credit and if either one was in danger of default. In order to qualify, the city would have to file a plan under which it could achieve a balanced budget within two full fiscal years, and would have to submit to State control of its fiscal affairs. The State would be obliged to pay a guarantee fee to the federal government, reimburse the federal government for any losses, and, if necessary, make a grant to the city equal to at least one-half of the city's operating deficit, above and beyond prior State assistance programs. Moreover, bond and note holders representing 65 percent of any obligations issued by a State agency on behalf of the city (MAC bonds) would have to agree to exchange existing bonds for federally guaranteed bonds with a later maturity date. The same agreement (but with the lower limit of 40 percent) would be required of the city's own bond and note holders for obligations maturing prior to June 30, 1976.

The federally guaranteed obligations would be limited to $4 billion the first year, $3.5 billion the second year, $2.5 billion the third year, and decreasing at least to $1.5 billion in the fourth year, after which the program would end.

In the case of a city which could not meet all of the necessary requirements outlined above, has defaulted or petitioned for bankruptcy, and is in danger of eliminating essential services, the bill would authorize federal guarantees of the city's own bonds, and the State would not have to reimburse the federal government for losses. However, only $500 million of guaranteed bonds could be outstanding at any one time, and no obligations with maturity dates of more than three months could be guaranteed. Authority to make these emergency guarantees would have expired very quickly, on March 31, 1976, whereas authority to make the larger, pre-default guarantees would not have expired until June 30, 1979. Otherwise, the features of the two programs are similar.

Both of the programs under the Senate bill would be administered by a three man board consisting of the Treasury Secretary, the Labor Secretary, and the Chairman of the Federal Reserve. Because it was anticipated that the State-paid guarantee fees would produce a profit, the bill would have established an emergency municipal debt fund to provide money for the guarantee programs, with supplements from the Treasury as needed.

If you have any questions, or wish for further information, please do not hesitate to call. Best wishes for the New Year.

Sincerely,

Brad C. Johnson

BCJ:plw
Enclosures
Ms. Amy Hirschhorn
Legislative Assistant
State of New York, Office of Federal Affairs
444 North Capitol Street, N.W.
Washington, D.C. 20001

Dear Ms. Hirschhorn:

This is in reply to your letter concerning the requirements of the Congressional Budget and Impoundment Control Act as applied to a possible extension of the New York City Seasonal Financing Act of 1975 (P.L. 94-143).

After reviewing the matter, it appears that a simple extension of P.L. 94-143 would not violate any provision of the Budget Act, nor would it require that additional amounts of budget authority or outlays be provided in the Second Budget Resolution for FY 1978. This result is due to the fact that the seasonal financing program is funded through a trust fund to which an appropriation has already been made. Extension of the program would delay repayment of the appropriation to the Treasury, but it would not appear to authorize the enactment of any new budget authority.

If you have further questions on the matter, please do not hesitate to contact me.

Sincerely yours,

Wendell Belew
Chief Counsel
REPORT
ON
THE NEW YORK CITY LOAN PROGRAM
FROM THE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

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On December 20 and 21, 1976, the Committee on Banking, Housing and Urban Affairs held oversight hearings on the New York City Seasonal Financing Act.

The law was enacted 1 year ago, on December 9, 1975. It provides for loans to New York City of up to $2.3 billion a year to cover seasonal shortfalls in revenues. The loans may be made only if the Secretary of the Treasury determines that there is a reasonable prospect of repayment, and they must be repaid in full at the end of each of the city's fiscal years, with interest at a rate of one percent above the Treasury's cost of borrowing. The legislation expires on June 30, 1978.

The loan program was an essential part of the financial package put together in late 1975 to avoid a New York City bankruptcy. Other parts of the package included the following:

(a) A State law instituting a 3-year moratorium on repayment of principal on $2.4 billion in short-term city notes coming due, and a reduction in the interest rate to 6 percent;
(b) $2.5 billion in loans from union pension funds over the same period, to meet the city's regular borrowing needs;
(c) An $800 million advance in State aid payments to the city, to be provided in each of these years; and
(d) About $900 million in additional city taxes.

Previously, the State had passed a law requiring New York City to adopt a 3-year financial plan to bring its budget into balance by June 30, 1978, and establishing an Emergency Financial Control Board headed by the Governor to oversee the city's financial affairs and its progress in meeting the Plan.

The committee held its first set of oversight hearings on the New York City loan program in April 1976. Since that time, there have been a number of new developments. First and foremost among them is the decision handed down by the New York State Court of Appeals on November 19, overturning the moratorium law. As a result of this decision, the city must come up with a plan for full repayment of close to $1 billion in notes previously under moratorium within the next year. This is over and above the spending cuts needed to balance the budget by June 30, 1978.

In the hearings, the committee explored the following questions:
- What progress is the city making toward meeting its financial plan and achieving a balanced budget?
- How is the city planning to resolve the problem of repaying that $1 billion in notes that were under moratorium?
- What are the prospects for the city's re-entering the credit markets in 1978 after the Federal loan program ends?
- What should be the Federal response to New York City's financial problems at this point in time?

Witnesses at the hearings included William E. Simon, Secretary of the Treasury and administrator of the New York City loan program; Abraham D. Beame, Mayor of the City of New York; and Hugh L. Carey, Governor of the State of New York.

SUMMARY OF FINDINGS AND RECOMMENDATIONS

Based on information obtained in the oversight hearings, the committee sees no need at the present time for any additional Federal assistance to New York City, either to repay the notes in moratorium or to extend the seasonal loan program beyond June 30, 1978. Moreover, it is the judgment of the committee that Congress would not approve any further aid for such purpose were it to be requested. The specific findings of the committee are as follows:

1. The committee finds that New York City is on target in carrying out its financial plan and that city officials are committed to meeting the requirement in State law of a balanced budget by June 30, 1978.

In particular, the committee finds that A
The city met its goal of $200 million in annualized budget cuts for fiscal year 1976, and is on schedule in making $400 million in budget reductions for fiscal year 1977.

b. Where shuffling has occurred, the city has successfully substituted other budget cutting actions in order to stay on target in carrying out the financial plan.

c. The City has made substantial improvements in its budgetary and financial control systems and is slated to have in place within the next year one of the most reliable municipal accounting systems in the country.

2. The committee finds that in many cases, budget reductions have been achieved without a substantial decline in the quality of services provided, owing to productivity measures instituted by the city and its employee unions.

3. The committee finds that there is improved investor confidence in New York City, as reflected in the Municipal Assistance Corporation's successful sale to the public of $256.3 million in bonds in early November 1976.

4. The committee finds evidence that both New York City and New York State are failing to collect large amounts of taxes owed, including $370 million in back real estate taxes recorded on the city's books, and that this aggravates the city's financial problems. Both Mayor Beame and Governor Carey expressed concern about this problem and indicated that they are taking steps to improve tax collections.

5. The committee finds that city and State officials have been working on a plan for repaying the $1 billion in short-term city notes affected by the moratorium decision, the basic elements of the plan being a restructuring of the MAC debt, sales of new securities, and cash from the city's budget. However, no formal agreement on a repayment plan has been reached by the other parties involved—the banks, the pension funds and the note holders.

6. The committee finds that if New York City successfully carries out its financial plan and repays the moratorium notes, then there should be far more investor confidence in the city's future by June 30, 1978, when the Federal loans end and the city has to meet its credit needs in the private market.

The principal recommendations are as follows:

1. The committee recommends that New York City and New York State maintain a firm commitment to balancing the city's budget by June 30, 1978, as required by State law, since it is unlikely that any additional Federal loans will be provided after that date.

2. The committee recommends that the city and State and the other parties involved make every effort to reach formal agreement on a plan to repay the $1 billion in moratorium notes in the near future, in order to relieve the uncertainties over New York City's financial future posed by the State Court of Appeals decision.

3. The committee recommends that New York City and New York State accelerate efforts already underway to collect more of the taxes due them and give particular attention to hiring additional auditors and taking vigorous action against property owners who are delinquent in their real estate tax payments for more than one year.

4. The committee recommends that the Secretary of the Treasury work with City officials to have them attempt some private borrowing to meet seasonal needs during the 1978 fiscal year, in order to prepare for re-entering the credit markets after the Federal loan program ends.
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BALANCING THE BUDGET

Under State law, New York City is required to develop and implement a financial plan designed to eliminate its budget deficit by June 30, 1978, and to show substantial progress toward balancing the budget in fiscal years 1976 and 1977. The plan must be approved by the Emergency Financial Control Board, a State agency headed by the Governor, which has final authority over New York City's fiscal and financial affairs.

As indicated, the financial plan provides for $200 million in mandatory budget cuts in fiscal year 1976, and spending cuts or revenue increases totaling $10.7 billion in fiscal year 1977 and $9 billion in fiscal year 1978. It also includes reductions in capital spending, removal of operating expenses from the capital budget over a 10-year period, and establishment of an accounting system and budgetary controls accurate enough to permit an independent audit by 1978.

The financial plan has come under criticism from various standpoints. Some critics have attacked its credibility and claimed that city officials lack the will and the ability to make the budget cuts required by the plan. Other have asserted that the city can achieve the cuts only at the cost of crippling its economy and have called for an extension of the budget-balancing deadline beyond the June 30, 1978 date.

Based on evidence obtained in the oversight hearings, the committee finds these criticisms unpersuasive. Up to this point, New York City officials have demonstrated an ability to plan and carry out the budget reductions required to eliminate the budget deficit by the date set in the law. The Emergency Financial Control Board has played its watchdog role well. Where slippage has occurred, where projected spending reductions have not been achieved, the Control Board has directed that substitute cuts be made. Thus, although some parts of the plan may not have yielded the expected savings, substitute actions have kept the plan as a whole on target. As a result, the committee found convincing evidence that New York City's financial plan will balance its budget by June 30, 1978.

Financial plan is being achieved

According to Mayor Beame's statement, New York City's year-end financial statements (the first issued in its history) show that the city accomplished its $200 million budget reduction program for fiscal year 1976 and finished the year with a deficit that was $83 million less than that projected in the financial plan. Furthermore, City Budget Director Kimmell testified that the city is not only on schedule but ahead of schedule in meeting its plan for the present fiscal year 1977:

The reason we were ahead of schedule results from the additional $50 million in reductions that the Emergency Financial Control Board required us to put in place in August as a hedge against slippage in the plan. The fact is that we have not had slippage equalling $50 million. We are on target and we are running ahead of schedule with regard to those scheduled budget reductions and savings necessary to meet the fiscal year 1977 Financial Plan period.

The mayor could not supply details of the program to close the budget gap in the last year of the plan, which begins on July 1, 1977, but he assured the committee that the program was in preparation and would be announced in early January.

In its previous oversight report, the committee called attention to the crucial importance of the city's carrying out its financial plan and recommended that the Treasury monitor the city's progress closely and also obtain an independent analysis of the city's expenditure reductions and revenue estimates. Secretary Simon stated that the Treasury had done this and that both the staff analysis and an independent review by a consultant, Arthur Andersen and Co., lent support to the mayor's claim that the city is achieving its financial plan for fiscal years 1976 and 1977. To quote from the Secretary's statement:
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In a separate report, Andersen concluded that, in general, New York City had taken the necessary administrative steps to implement its deficit reduction program in concrete terms. For example:

Since the beginning of its financial crisis, New York City has reduced the size of its payroll by more than 50,000 jobs.

The city has reached agreements with its unions, representing more than 200,000 employees, providing for a freeze in wage costs through fiscal 1978 and a $24 million reduction in fringe benefits.

The city has closed all or major portions of three hospitals and expects to close down additional health facilities.

The city has ended a century old tradition of free tuition at its City University and has announced that it will not contribute to the operating expenses of CUNY's senior colleges in fiscal 1978.

These measures, and many others, resulted in achievement of the objective of $200 million in budget cuts in fiscal 1976. Moreover, according to Andersen's review, the necessary administrative actions to accomplish a $400 million budget reduction in the current fiscal year are in place. Accordingly, there is substantial basis for concluding that at least $400 million in budget reductions will be realized in fiscal 1977.

Secretary Simon told the committee that another report done by Arthur Andersen concluded that the city had instituted interim measures to improve its budgetary and financial control systems and that it was on schedule in installing the new Integrated Financial Management System. This means that the financial information reported by the city is far more reliable than ever before.

The Committee was glad to hear from Mayor Beame that in many cases, budget reductions have been achieved without any substantial decline in the quality of services provided, due to the "intensive employee productivity program initiated by the city and its employee unions." The mayor gave several examples in his statement:

In the fire department, for example, we have cut back our manning level 10 percent since 1975, and it is now at the level it was in 1968. However, we have maintained our response time despite a 26 percent increase in the number of alarms.

In the parks department 50 percent of the seasonal employees have been separated and 25 percent of the overall staff. Nevertheless, the department has performed its mission.

In the sanitation department there has been a 21 percent decline in the number of employees since 1975, but the number of tons of refuse collected per truck shift has increased.

The committee recognizes that it is not easy for New York City to make budget reductions of this magnitude and that this is bound to cause problems in some areas. Nonetheless, it is essential that the city bring its spending levels within its means. Thus it is commendable that the city and its employees have been able to offset spending cuts with productivity gains in a number of instances.
Uncollected taxes, aggregate city and State financial problems.

The committee received information from Paul DuBrul, special assistant to Bronx Borough President Robert Abrams, contending that the financial problems of both New York City and New York State are aggravated by "failure to collect vast amounts of taxes due and owing (and collectible)." The New York State Commissioner of Taxation and Finance, James H. Tully, Jr., has stated publicly that the State loses $500 million a year in sales taxes and $350 million a year in income taxes. According to DuBrul, there is also an estimated loss of $200 million in corporate taxes and $200 million in miscellaneous other State taxes, including $25 million in cigarette taxes. New York City loses two ways: first, through failure to collect some of its own taxes, and second, through the State's failure to assess the taxes it is supposed to collect on the city's behalf. The largest single item on the city's books is $770 million in back real estate taxes. Other estimated losses indicated by DuBrul include $200 million in sales taxes, $100 million in corporate taxes, $200 million in income taxes, $100 million in cigarette taxes, and $200 million in parking fines.

While most of these figures are estimates, they do give strong evidence that New York City and State are suffering great revenue losses which they can ill-afford and that better collection practices could improve the financial picture considerably. The State of Wisconsin, for example, with a much smaller budget, has managed to collect an additional $52 million and minimize tax losses through the use of 200 auditors who pay for themselves many times over in increased revenues.

Governor Carey expressed his concern about this problem and told the committee that New York State is now engaged in an effort to improve tax collections, based on the Wisconsin model. He described some of the measures now underway:

- I sought and got authorization from the legislature to have a monthly instead of quarterly collection of sales taxes. That has reduced the loss in slippage of sales taxes.
- As well, there have been auditors added to the State Tax and Finance Department.
- We have undertaken as well the collection of the city's income tax for the city at savings to the city.
- The indications are at this time that we will improve the collection of city income taxes by having a joint return under which the taxpayer within the city files city and State income tax statement.
- Processing of these returns will be on a more effective basis.
- We are introducing the very systems and improvements into that department that we have learned from the studying of tax collection policies in other states, particularly the State of Wisconsin.

Mayor Beame and Budget Director Kummerfeld stated that New York City is also working to improve its tax collections. A major barrier to real estate tax collections has been a city law allowing proceedings against a delinquent property owner only after 3 years of default. A new law effective January 1, 1977, changes that period to 1 year and should give the city more power to collect real estate taxes owed. However, Kummerfeld noted that some of the back taxes recorded on the books have been shown by audit to be mistakenly billed, and that the city is making an effort now to correct its tax rolls and remove properties that are abandoned or are wholly or partially tax exempt. Kummerfeld stated that the city is "very much concerned" about uncollected taxes:

We have taken a hard look at the uncollected taxes, backlogs, receivables.

We have added in the staff, office of the city controller and finance administration, men for this purpose. There are 100
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The committee believes it is important for New York City and New York State to collect more of the taxes due them, and that both should accelerate efforts already undertaken in this area, in view of their pressing financial problems. While auditors and other tax collecting operations do cost money, the results generally repay that cost many times over. It is particularly important that the State improve its operation, since it is the collection agent for many of the city's taxes as well. In this regard, the committee recommends that New York State consider joining the Multi-State Tax Commission, a joint agency of 21 State governments which audits major corporations operating across State lines and has recovered millions of dollars in tax revenues for its member States. In addition, the committee recommends that New York City give top priority to collecting back real estate taxes under its new law, especially from large property holders with long records of tax arrearage.

Budget-balancing deadline can be met

While it will not be easy, the committee finds that New York City should be able to meet the present deadline and balance its budget by June 30, 1978. Indeed, the committee did hear any sentiment expressed in favor of extending the budget-balancing period. As Assistant Treasury Secretary Gerard stated, "The fact of the matter is that nobody is in a position to deal with the financial plan or to evaluate it directly has taken the position that it's not doable by 1978."

Mayor Beame assured the committee that New York City has every intention of carrying out the Financial Plan on schedule: "I am committed, the city is committed, to a balanced budget for next year. We are going to do that." In concluding his statement, the mayor offered the Committee this encouraging assessment of New York City's financial situation, after the struggles of the past year:

The fiscal crisis has given the city a chance, albeit a painful one, to review, reorganize and revise its governmental operations. We will achieve the goals of the financial plan, and we are better prepared to face the future than ever before.

In view of all this, the committee sees no need for any extension of the period for balancing the budget beyond the June 30, 1978 date set by State law. The sooner that New York City can accomplish this difficult task, the faster it can go about the more important effort of revitalizing its economy, by implementing the types of business tax cuts and other recovery measures announced by the Mayor the day before he testified at the committee's hearings.

IMPACT OF THE NOTE MORATORIUM DECISION

In November 1975, with New York City facing the prospect of default on its obligations coming due, the New York State Legislature passed a law imposing a 3-year moratorium on payment of principal on $2.4 billion in short-term city notes, and a reduction in the interest rate to 6 percent. Shortly thereafter, the major New York City banks and the pension funds agreed to defer repayment for 10 years and accept lower interest rates on $819 million worth of those notes. Subsequently, other noteholders agreed to exchange an additional $816 million for 10-year MAC bonds at 8-percent interest. This left slightly less than $1 billion in city notes directly subject to the moratorium.
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One year later, on November 19, 1976, the New York State Court of Appeals overturned two lower court decisions and ruled the moratorium unconstitutional, on the grounds that it violated a requirement in the State Constitution that a municipality pledge its “faith and credit” for the repayment of any indebtedness which it incurs. The court held that the noteholders were entitled to be repaid, but not “immediately” or by any “measures unnecessarily disruptive of the city’s delicate financial and economic balance.” Attorneys representing the Flushing National Bank of Long Island, which brought the suit challenging the moratorium, were instructed to act on behalf of the bank and other noteholders similarly situated in working out an agreement with the city to repay the $1 billion in notes outstanding. The effect of the court of appeals decision on the other notes which were extended or exchanged is still in question and under consideration by the courts.

In the immediate aftermath of the moratorium decision, the committee was concerned about its implications for New York City's financial recovery, for a number of reasons. First, it called into question the city’s ability to show a reasonable prospect of repayment of the Federal loans needed in December and beyond and to repay the $1.075 billion in loans already outstanding. Second, the belief was expressed in many quarters that the city could not handle this new crisis and that the Federal Government would have to step in and provide additional aid to pay off the notes, or otherwise face new threats of a city bankruptcy. Third, since the moratorium was a crucial part of New York City’s financial plan, its removal raised serious questions about the city’s ability to accomplish its budget-balancing efforts by the June 30, 1978 deadline.

Since that time, these concerns have largely been dispelled. Secretary Simon assured city officials by the following day that the loans would be continued, and representatives of the State and city have been engaging in a concerted effort to obtain the new resources needed to pay off the notes in moratorium, over and above the requirements of the financial plan. And while the latter issue has yet to be resolved, the committee believes that an acceptable payment plan can be worked out in the near future.

Continuation of the Federal loans to New York City

One of the first questions raised after the moratorium decision was announced was whether or not the Secretary of the Treasury would authorize the $770 million in Federal loans which the city was then planning to request for the month of December, given the uncertainty about the city’s ability to cope with the additional financial strains imposed by the decision.

It is the view of the committee, as confirmed by the Secretary, that there is ample authority both in the law and in the credit agreement pursuant to the law for the Secretary of the Treasury to refuse further loans to New York City and demand repayment of any loans outstanding, if he determines that this is required to protect the Federal interest. The New York City Seasonal Financing Act states that the loans shall be provided only if the Secretary determines that there is “a reasonable prospect of repayment,” and section 7.1.5 of the credit agreement permits the Secretary to demand payment immediately if “an adverse decision is rendered in litigation materially and adversely affecting the likelihood of fulfillment of the city financial plan.”

However, Secretary Simon told the Committee that after careful analysis, he decided to inform City officials immediately that the December loans would be authorized, because this “allowed the development of a plan for repayment of the moratorium notes to proceed in an orderly manner, without the fear that essential services would be cut due to the absence of anticipated Federal funds.” The Secretary listed the factors which led him to decide that there was a reasonable prospect of repayment of the Federal loans:
First, pursuant to the credit agreement, New York City has irrevocably pledged to the Treasury $2.4 billion in revenues from State sources, more than enough to repay principal and interest on the estimated $2.1 billion loans. Furthermore, as additional security, the act authorizes Treasury to claim Federal source revenues due the city. Third, if satisfactory arrangements to finance repayment of the moratorium debt can be developed, as I believe they can, then the city's cash flow appears more than adequate to repay the seasonal loan without impairing essential services. Finally, the provisions of title 31 of the United States Code, section 191, give the Treasury an absolute first priority on the resources of any entity indebted to us.

The Secretary also noted that an immediate announcement confirming the December loans eliminated an uncertainty in the market and kept the value of MAC bonds from falling substantially, "an important consideration since the sale of new MAC obligations is likely to be required as part of a solution to the moratorium problem."

The committee believes that the Secretary fulfilled the terms and conditions of the law and acted responsibly in authorizing the December loans to the city despite the uncertainties surrounding the moratorium decision. Given the fact that sufficient revenues to repay all the fiscal year 1977 loans were already pledged to the Treasury, it was in the best interests of all parties concerned for the Secretary to seek to ease the impact of the court of appeals decision.

Prospects for repayment of the notes

In the first few days after the moratorium decision was handed down, the committee was disturbed to hear reports that New York City would be looking to the Federal Government for additional financial aid to pay off the $1 billion in notes. Fortunately, it now appears that city and State officials have abandoned this view and undertaken a concerted effort to obtain the money needed from the resources available to them. Secretary Simon offered the committee his assurances on this point:

"...it seems clear now that all the relevant parties are committed to achieving a solution at the state and local level. Thoughts of new forms of Federal credit assistance specifically to deal with this problem, while widely discussed a month ago, have been desisted by the realities here in Washington and by recognition that a solution at other levels of government was both feasible and possible."

Mayor Beame told the committee that the city is in a far better position to deal with a financial problem of this magnitude now, after a year of budget-cutting and belt-tightening:

"A year ago, the City's options in such a crisis would have been limited to a total federal solution or bankruptcy. Today, however, we can face crisis without chaos. The prices of city and MAC securities in the market place and the willingness of the capital market to accept MAC securities reflect the progress we have made. This in turn has made it possible for us to present a proposal which includes a sale of securities as well as city cash."

Felix Robertyn, chairman of the Municipal Assistance Corporation (MAC), the State agency set up to borrow on the city's behalf, has been in charge of the effort to repay the notes. He described to the committee the principal elements of a repayment plan developed by MAC and the city in December:
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A voluntary restructuring of $1.8 billion of MAC 10-year debt held by certain New York City institutions—mainly banks and pension funds—which could make available $206 million for noteholders in the current fiscal year, if stretched to 15-year maturities.

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

A public sale of MAC securities, also of between $250 and $300 million. The recent successful sale of MAC bonds convinces me that, if the rest of the plan can be put together, the strong current bond market would accept this new offering at a reasonable rate of interest. The current favorable market climate may obviously, no longer prevail if our negotiations are too protracted.

Perhaps $250 million in cash generated by the city, using the previously planned refinancing of Mitchell-Lama mortgages on middle-income housing.

We estimate that these elements of our proposal could be accomplished on a schedule that would produce $206 million by February 1, approximately half of the total, by June 30, and the balance by next November 19, 1 year from the court's decision.

However, Robatyn told the committee that none of the parties whose agreement is required to implement the plan had yet given formal consent to its terms and conditions. When the city presented the plan to the court, the attorney for Foshing National Bank accepted the schedule of payments proposed, but refused to accept the plan as a whole so long as it was contingent on agreements not yet confirmed by the banks and the pension funds. The court permitted the city an additional thirty days (with subsequent extension to February 3) either to obtain commitments from the parties involved or to come up with an alternative plan.

In the period since the oversight hearings were held, the details of the proposed plan have undergone some modifications, but the basic elements have remained the same: MAC debt restructuring, sales of new securities, and cash from the city's budget. The first element, the debt restructuring, is also a crucial part of the city's budget-balancing plan. It is supposed to result in cash savings to the city of $206 million in the 1977 fiscal year (to be used for repayment of the notes), $203 million in the 1978 fiscal year (to eliminate part of the budget deficit), and then $170 million for the 2 succeeding years.

However, there has not yet been any agreement by the parties involved either on a repayment plan or on the MAC debt restructuring. While it would not be appropriate to comment on the details of the ongoing negotiations, it is clearly in the interest of all parties concerned to reach agreement as soon as possible on both matters, in order to relieve the uncertainties surrounding New York City's financial future and to realize the full savings projected from the restructuring effort.

It is the considered judgment of the committee that Congress would not approve any additional Federal assistance to New York City for the purpose of paying off the $1 billion in notes affected by the moratorium decision. Thus it is important that the parties involved in the negotiations make every effort to work out the details of the repayment plan so that a formal agreement can be concluded in the very near future.
BEF—MONO—12

RE-ENTERING THE CREDIT MARKETS

In the course of the oversight hearings, the committee gave some consideration to the question of whether or not New York City will be able to re-enter the credit markets to meet its borrowing needs after June 30, 1978, when the Federal loans end. This will be the crucial test of the financial plan and of the success of New York City's efforts to regain financial stability.

Secretary Simon told the committee that he continues to be "cautiously optimistic" about the City's prospects:

- if they proceed down the road to achieving budget balance, fiscal and financial credibility at the end of 1978, and have an accounting system that people can understand and audit, then they will return to the capital markets in fiscal year 1979.

Moreover, Simon expressed the view that the moratorium decision could actually help the city in the long run, if the immediate problem of the note repayment is handled successfully. He pointed out that the court of appeals decision has obviated certain concerns which surrounded the note moratorium:

First, it has been argued that the existence of the notes in moratorium would create both financial and psychological barriers to New York City's re-entry to the capital markets in fiscal 1979. More generally, the moratorium was viewed by many as clouding the value of a far broader range of obligations—certainly the securities of issuers within New York State—and thus having a pervasive adverse effect on the municipal bond market, an important, integral and growing sector of our capital market structure. The court's decision eliminates both concerns, substantially improving the prospects for the future.

City and State officials were more cautious about the prospects for New York City's re-entering the credit markets in late 1978, and somewhat less optimistic. Governor Carey put it this way:

We will be in technical balance in 1978. But we have to ask the question as to whether a market will open up for a city in which the schools, the state of our health systems, the state of our transportation, are all in decline. This is a question which I think investors are going to look at as hard as they are going to look at the balanced budget sheet.

The committee realizes that this is a tough judgment call and believes it is too soon to tell whether or not New York City will get back into the credit markets in fiscal year 1979. However, there is reason to believe that if New York City successfully carries out all aspects of its financial plan and the repayment of the notes in moratorium, then there should be far more investor confidence in the city's future eighteen months from now.

In its previous report, the committee recommended that the Secretary of the Treasury insist on compliance with section 6.11 of the credit agreement, which requires the city to use its best efforts on and after July 1, 1977, to meet its seasonal borrowing needs in the private markets without resort to the Federal loans. It is possible that the effect of the repayment plan for the notes in moratorium, which involves some private borrowing by MAC, would make it more difficult for the city to undertake such an effort as early as next July. Nonetheless, Secretary Simon said he would recommend to his successor Mr. Blumenthal, that the possibilities of the city's doing this be explored.

The committee believes it is essential that New York City "rest the waters" and try to do some private borrowing before the Federal loans expire, in order for it to regain access to the credit markets after that date. Thus the committee recommends that the Secretary of the Treasury work with city officials to have them attempt some borrowing to meet seasonal needs, as an alternative to Federal loans, as early as it appears feasible in the city's 1978 fiscal year.
While the need for the New York City Seasonal Financing Act was precipitated by the crisis which arose in 1975 regarding the management of the city's debt and expenditures, it should also be recognized that not only New York but other cities suffer from deep-seated economic problems which affect their long-term fiscal soundness. The committee believes that the exposure of the Federal taxpayer under the Seasonal Financing Act makes oversight of the loan extended under that act an important responsibility, but the longer-term economic health of New York and our Nation's other cities is also of great concern to the committee.

As Senator Brooke said at our hearings, "... this committee should not have to act as an 'emergency room' for ailing cities ... action must be taken to restore the health and vitality of our older urban areas."

There is a growing recognition that many of our Nation's cities are experiencing a long-term decline in their economic base. However, national consensus about the best way to deal with this problem has yet to emerge. At the Federal level, there is a plethora of programs available to State and local governments, dealing with almost every aspect of State and local activity, from education to law enforcement, to urban renewal. In addition, there are a number of programs to deal directly with the problems of lower-income persons, many of whom live in our cities—aid to families with dependent children, food stamps, and rent supplements to name a few. Jurisdiction over these programs is divided among various departments in the executive branch and various committees within the Congress.

The economic condition of New York and many other cities points to the need for a rethinking of the Federal relationship with our cities and the people who live in them. We must seek a new national consensus about the responsibilities of each level of government—Federal, State, and local.

The committee believes the Congress and the Administration should undertake a thorough review of Federal urban policy. Such a reexamination of the Federal role in urban affairs is needed, if the economic health of our cities is to be restored and a decent standard of living is to be maintained. We recognize that continued good faith efforts on the part of New York and other cities to achieve fiscal integrity should be met by a good faith consideration of the broad and local problems presented in the field of urban affairs. The committee intends to do what it can to meet our responsibility.
NEW YORK CITY SEASONAL FINANCING.
ACT OF 1975

For Legislative History of Act, see p. 1258

An Act to authorize the Secretary of the Treasury to provide seasonal financing for the city of New York.

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

SHORT TITLE

Section 1. This Act may be cited as the “New York City Seasonal Financing Act of 1975”.

FINDINGS AND DECLARATIONS

Sec. 2. The Congress makes the following findings and declarations:
(1) It is necessary for the city of New York to obtain seasonal financing from time to time because the city's revenues and expenditures, even when in balance on an annual basis, are not received and disbursed at equivalent rates throughout the year.
(2) At the present time the city is or may be unable to obtain such seasonal financing from its customary sources.
(3) It is necessary to assure such seasonal financing, in order that the city of New York may maintain essential governmental services.

DEFINITIONS

Sec. 3. As used in this Act:
(a) "City" and "State" mean the city and State of New York, respectively.
(b) "Financing agent" means any agency duly authorized by State law to act on behalf or in the interest of the city with respect to the city's financial affairs.
(c) "Secretary" means the Secretary of the Treasury.

LOANS

Sec. 4. (a) Upon written request of the city or a financing agent, the Secretary may make loans to the city or such financing agent subject to the provisions of this Act, but in the case of any loan to a financing agent, the city and such agent shall be jointly and severally liable therefor.
(b) Each such loan shall mature not later than the last day of the city's fiscal year in which it was made, and shall bear interest at an annual rate 1 per centum per annum greater than the current average market yield on outstanding marketable obligations of the United States with remaining periods to maturity comparable to the maturities of such loan, as determined by the Secretary at the time of the loan.

SECURITY FOR LOANS

Sec. 5. In connection with any loan under this Act, the Secretary may require the city and any financing agent and, where he deems necessary, the State, to provide such security as he deems appropriate.

89 STAT. 797
The Secretary may take such steps as he deems necessary to realize upon any obligation in which the United States has a security interest pursuant to this section to enforce any claim the United States may have against the city or any financing agent pursuant to this Act. Notwithstanding any other provision of law, Acts making appropriations may provide for the withholding of any payments from the United States to the city, either directly or through the State, which may be or may become due pursuant to any law and offset the amount of such withheld payments against any claim the Secretary may have against the city or any financing agent pursuant to this Act. With respect to debt incurred pursuant to this Act, for the purposes of section 3505 of the Revised Statutes (33 U.S.C. 714), the term ‘person’ includes the city or any financing agent.

LIMITATIONS AND CRITERIA

31 USC 1505.

Sec. 6. (a) A loan may be made under this Act only if the Secretary determines that there is a reasonable prospect of repayment of the loan in accordance with its terms and conditions. In making the loan, the Secretary may require such terms and conditions as he may deem appropriate to ensure repayment. The Secretary is authorized to agree to any modification, amendment, or waiver of any such term or condition as he deems desirable to protect the interests of the United States.

(b) At no time shall the amount of loans outstanding under this Act exceed the aggregate $5,500,000,000.

(c) No loan shall be provided under this Act unless (1) the city and all financing agents shall have paid according to their terms all prior loans under this Act which have matured, and (2) the city and all financing agents shall be in compliance with the terms of any such outstanding loans.

REQUIREMENTS

31 USC 1506.

Sec. 7. The remedies of the Secretary prescribed in this Act shall be cumulative and not in limitation of or in substitution for any other remedies available to the Secretary or the United States.

FUNDING

Sec. 8. (a) There is hereby established in the Treasury a New York City Seasonal Financing Fund to be administered by the Secretary. The fund shall be used for the purpose of making loans pursuant to this Act. There is authorized to be appropriated to such fund the sum of $5,500,000,000. All funds received in the Treasury by the Secretary in the payment of principal of any loan made under this Act shall be paid into the fund. All income from loans and investments made from the fund shall be covered into the Treasury as miscellaneous receipts. 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. After all loans made pursuant to this Act have been repaid, the balance of the fund shall be returned to the general fund of the Treasury.

(b) The Secretary is authorized to sell, assign, or otherwise transfer from the fund any notes or other evidence of any loan made pursuant to this Act to the Federal Financing Bank and, in addition to its other powers, such Bank is authorized to purchase, receive, or otherwise acquire the same.

89 STAT. 798
NEW YORK FINANCING ACT, 1975

(c) There are authorized to be appropriated such sums as may be necessary to pay the expenses of administration of this Act.

SECTION 9. At any time a request for a loan is pending or a loan is outstanding under this Act, the Secretary is authorized to inspect and copy all accounts, books, records, memorandums, correspondence, and other documents of the city or any financing agent relating to its financial affairs.

AUDITS

Sec. 10. (a) No loan may be made under this Act for the benefit of any State or city unless the General Accounting Office is authorized to make such audits as may be deemed appropriate by either the Secretary or the General Accounting Office of all accounts, books, records, and transactions of the State, the political subdivision, if any, involved, and any agency or instrumentality of such State or political subdivision. The General Accounting Office shall report the results of any such audit to the Secretary and to the Congress.

TERMINATION

Sec. 11. The authority of the Secretary to make any loan under this Act terminates on June 30, 1977. Such termination does not affect the carrying out of any transaction entered into pursuant to this Act prior to that date, or the taking of any action necessary to protect or preserve the interests of the United States arising out of any loan under this Act.

Approved December 9, 1975.

LEGISLATIVE HISTORY:

HOUSE REPORTS: No. 94-122 (Comm. on Banking, Currency and Housing), Pt. 2 (Comm. on Ways and Means),

SENATE REPORT No. 94-623 (Comm. on Banking, Housing and Urban Affairs)

CONGRESSIONAL RECORD, Vol. 121 (1975):
Dec. 2, considered and passed House;
Dec. 3-5, considered and passed Senate.
July 28, 1977

Mr. Eugene Keilin
Executive Director
Municipal Assistance Corporation
Two World Trade Center
New York, New York 10047

Dear Mr. Keilin:

I thought you might be interested in the attached.

If you have any questions, please call me.

Sincerely,

Amy Hirschhorn
Legislative Assistant

AII/plw
Attachment
Ms. Amy Hirschhorn  
Legislative Assistant  
State of New York, Office of Federal Affairs  
444 North Capitol Street, N.W.  
Washington, D.C. 20001

Dear Ms. Hirschhorn:

This is in reply to your letter concerning the requirements of the Congressional Budget and Impoundment Control Act as applied to a possible extension of the New York City Seasonal Financing Act of 1975 (P.L. 94-143).

After reviewing the matter, it appears that a simple extension of P.L. 94-143 would not violate any provision of the Budget Act, nor would it require that additional amounts of budget authority or outlays be provided in the Second Budget Resolution for FY 1978. This result is due to the fact that the seasonal financing program is funded through a trust fund to which an appropriation has already been made. Extension of the program would delay repayment of the appropriation to the Treasury, but it would not appear to authorize the enactment of any new budget authority.

If you have further questions on the matter, please do not hesitate to contact me.

Sincerely yours,

Wendell Beloe  
Chief Counsel
Mr. Stephen Berger, Executive Director
Emergency Financial Control Board
270 Broadway
New York, New York 10007

Dear Steve:

Attached are copies of two bills which I introduced yesterday. One seeks to extend the New York City Seasonal Financing Act of 1975, and is intended primarily for your information. The second, The National Development Act of 1977, has, I believe, tremendous potential.

As the summary indicates, the measure identifies three main areas of need: 1) the need of access to operating funds, at reasonable rates, by cities and counties throughout the nation; 2) the need to extend special assistance to depressed urban and rural areas characterized by high levels of unemployment and underemployment; and 3) the dual need to produce more low- and moderate-income housing and assist the construction industry.

I am the only New York City member on the House Banking, Finance and Urban Affairs Committee which has the responsibility of dealing with the City's problems, and intend to do everything within my power to assure speedy hearings on this measure. Because the proposals contained therein--bond guarantees, direct and guaranteed loans for economic development to businesses and industries, as well as money for housing and construction of public facilities--are of enormous importance to our City, I would welcome receiving your reactions to the measure. If you have specific points you wish to discuss before responding, please have your staff contact my administrative assistant, Mira Luy, who is working on this matter for me.

Sincerely yours,

[Signature]

HERMAN BADILLO
MEMBER OF CONGRESS
SUMMARY OF NATIONAL DEVELOPMENT ACT OF 1977

The legislation identifies three main areas of need:

1. The need of access to operating monies by cities, towns, counties, etc. at reasonable rates of interest;

2. The need to extend special assistance to "depressed urban and rural areas" which are defined as areas of high unemployment and under-employment; areas losing employment opportunities because of loss of businesses, or areas which experience substantial outmigration;

3. The need to achieve the national housing goal by making more housing available to low- and moderate-income families and to assist the faltering construction industry.

It proposes to deal with these issues by establishing a National Development Bank, which would:

1. Guarantee the bonds of cities, towns, etc. if they cannot obtain money elsewhere at "reasonable rates" stipulated for the purposes of this bill at no more than two percent higher than the rates paid by the states in which they are located. The conditions for this program are stringent and call for a balanced budget;

2. Authorize direct loans and guarantee loans for the purpose of attracting industries, keeping industries, establishing job training programs and developing community facilities and services;

3. Increase housing available to low- and moderate-income families by loaning money for the construction of low and moderate income housing in depressed urban and rural areas, both for the purpose of increasing the available housing and beefing up the construction industry.

Total authority for guarantee of bonds of cities, counties, etc.: $10 billion
CONGRESS

H.R.

SESSION

IN THE HOUSE OF REPRESENTATIVES

Mr. Badillo introduced the following bill; which was referred to the Committee on

A BILL

To establish a National Development Bank to guarantee the payment, in whole or in part, of interest, principal, or both, of obligations of States (including agencies and instrumentalities thereof as described therein) and to provide loans to finance urgently needed public facilities for State and local governments, to help achieve a full employment economy both in urban and rural America by providing loans for the establishment of small and medium size businesses and industries, and the expansion and improvement of such existing businesses and industries, and for the construction of low and moderate income housing projects, and to provide job training for unskilled and semiskilled unemployed and underemployed workers.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "National Development Act of 1977".
Section 100--Findings and Declaration of Purpose

(1) Tax and other financial sources currently available to State and local governments are strained beyond their capacity to achieve sound and orderly development of the Nation's communities, accommodate our growing population, and, in some instances, to provide essential public services and facilities.

(2) The existing institutional structure for providing funds--municipal bonds--cannot provide at reasonable cost the amounts necessary to satisfy these growing and specialized needs and demands. Local governments, competing for funds, are increasingly forced to pay interest rates so high as to make debt service an ever-increasing portion of their budgets. Constrained by shrinking tax bases and the increasing costs of unemployment benefits and welfare, as well as other public services, they are forced to reduce or eliminate services in order to meet interest payments. This is clearly contrary to the national interest. Considerations of national welfare make it imperative that we mobilize the full resources available at all levels of government--Federal, State and local--to prevent further blight and enhance instead healthy economic development.

(3) In addition, every effort must be made to eliminate the Nation's housing crisis and achieve the National housing goal established by Congress, particularly as that goal applies to low- and moderate-income families who are most in need.
Doing so will serve a two-fold purpose in these times of economic stress: it will increase the inventory of housing stock available and, simultaneously, reduce unemployment in the construction industry which has proven most sensitive to the twin pressures of inflation and depression.

TITLE I--NATIONAL DEVELOPMENT ACT OF 1977
Section 101--Definitions and Rules of Construction

(a) The definitions and rules of construction set forth in this section shall be applicable for the purposes of this Act.

(b) The term "State" means any State, the District of Columbia, the Commonwealth of Puerto Rico, or any territory or possession of the United States.

(c) The term "political subdivision" shall have the same meaning as used in section 103 of the Internal Revenue Code of 1954.

(d) The term "agency or instrumentality of a State" means an entity created by the State for a specific purpose which, as a political subdivision, is a creature of the State. Any action authorized or required under this Act by or with respect to any State may be taken by or with respect to any agency or instrumentality thereof approved by the Bank for that purpose, having regard to the purposes of the State law creating any such agency or instrumentality.
(e) The term "acceptable interest rate" for the purposes of this Act means an interest rate no more than two percentum higher than that paid by the State in which the applying political subdivision is located on its own obligations.

(f) The term "public facility" means the structures and equipment owned and operated by State and local governments to provide medical, social, educational, transportational, pollution control, and recreation services.

(g) The term "low and moderate-income housing" shall have the meaning given it under definitions made by the Secretary of Housing and Urban Development in establishing criteria by which families qualify for occupancy or dwellings supplied under the low- and moderate-income rental and homeownership programs of the National Housing Act.

(h) The term "depressed urban and rural areas" means those areas which may be designated without regard to political boundaries by the Secretary of Labor, the Secretary of Commerce, and the Director of the Community Services Administration on the basis of the most recent appropriate annual statistics for the most recent calendar year, as having a rate of unemployment at least two percentum higher than the national average for the preceding six months, or a rate of unemployment at least one percentum higher than the national average for the preceding year, or an underemployment rate at least two percentum higher than the national average for the preceding six months, or one percentum higher than the national average for the preceding year, or where pending loss of business or industry is expected to produce such conditions, or those areas characterized by ___________________________
substantial outmigration resulting from the lack of job opportunities, or those areas suffering from other conditions which in the judgment of the Board of Directors of the Bank qualify them for assistance under the provisions of this Title.

(i) The term "adequate wage" means a wage which shall not be lower than the highest of (1) the minimum wage under the Fair Labor Standards Act of 1939, (2) the minimum wage set by State and local governments, and (3) the prevailing rate of wages in the area for comparable work.

(j) The term "underemployed" for the purposes of this Act means a person whose income is less than 80 percent of the median income for the area as determined by the Secretary of Housing and Urban Development for the purposes of the section 8 Housing Assistance Program of the National Housing Act.

Section 102--Establishment of the Bank

The management of the Bank shall be vested in a Board of Directors (hereinafter referred to in this Title as the "Board of Directors") composed of the Secretary of the Treasury, as Chairman, the Secretary of Housing and Urban Development, the Secretary of Health, Education, and Welfare, the Chairman of the Board of Governors of the Federal Reserve System, and the Chairman of the Securities and Exchange Commission. Decisions of the Board of Directors shall be made by majority vote.
Section 103--Appointment of Officers and Employees

The Board of Directors shall appoint a President of the Bank and such other officers and employees as it deems necessary to carry out the functions of the Bank. Such appointments may be made without regard to the provisions of title 5, United States Code, governing appointments in the competitive service, and persons so appointed may be paid without regard to the provisions of chapter 51 or subchapter III of chapter 53 of such title relating to classification and General Schedule pay rates. The President of the Bank shall be an ex officio member of the Board of Directors and may participate in meetings of the Board except that he shall have no vote except in case of an equal division. No individual other than a citizen of the United States may be an officer of the Bank. No officer of the Bank shall receive any salary or other remuneration from any source other than the Bank during the periods of his or her employment by the Bank.

Section 104--Conflict of Interest

(a) No director, officer, attorney, agent or employee of the Bank shall in any manner, directly or indirectly, participate in the deliberations upon or the determination of any question affecting his or her personal interests, or the
interests of any corporation, partnership, or association in which he or she is directly or indirectly interested.

(b) The Bank shall not engage in political activities nor provide financing for or assist in any manner any project or facility involving political parties, nor shall the directors, officers, employees, or agents of the bank in any way use their connection with the Bank for the purpose of influencing the outcome of any election.

Section 105--General Corporate Powers

Except to the extent inconsistent with the provisions of this Title, the Bank shall have the general corporate powers of a corporation organized and existing under the laws of the District of Columbia.

Section 106--Principal Office; Branches

The principal office of the Bank shall be located in the District of Columbia, and it may establish agencies or branch offices in any city of the United States.

Section 107--Capital Stock

(a) The Bank shall have capital stock of $2,000,000,000 subscribed by the United States, payment for which shall be subject to call in whole or in part by the Board of Directors.

(b) The Secretary of the Treasury is authorized to, and upon the request of the Board of Directors shall, purchase stock in amounts designated by the Board of Directors up to a total of $4,000,000,000.
Section 108--Borrowing Authority

(a) The Bank may issue notes, debentures, bonds, and other evidences of indebtedness in such amounts and on such terms and conditions as its Board of Directors may determine subject to the limitations prescribed in this Act.

(b) The aggregate outstanding indebtedness of the Bank under this section at any time may not exceed twenty times the paid-in capital stock of the Bank at that time.

(c) The obligations of the Bank under this section shall be fully and unconditionally guaranteed both as to interest and principal by the United States and such guarantee shall be expressed on the face thereof.

(d) In the event that the Bank is unable to pay upon demand, when due, any obligation under this section, the Secretary of the Treasury shall pay the amount thereof and thereupon to the extent of the amount so paid, the Secretary of the Treasury shall succeed to all the rights of the holder of the obligations.

Section 109--Purchase of Assets by the Treasury

The Secretary of the Treasury is authorized to purchase from the Bank any asset of the Bank at such price as may be agreed upon between the Secretary of the Treasury and the Bank.
Section 110--Discount by Federal Reserve Bank

(a) The several Federal Reserve banks are authorized to purchase or discount any note, debenture, bond, or other obligation, secured or unsecured, held by the Bank.

(b) Obligations of the Bank are eligible for purchase by the Federal Reserve Open Market Committee.

(c) Obligations of the Bank are eligible for purchase by any federally chartered or regulated commercial bank, savings and loan association, or mutual savings bank.

Section 111--Investment Status of Obligations of the Bank

All obligations issued by the Bank shall be lawful investment for, and may be accepted as security for, all fiduciary, trust, and public funds the investment or deposit of which is under the authority or control of the United States or of any officer or officers thereof.

Section 112--Authority for Guarantees

The Bank may guarantee the payment, in whole or in part, of interest, principal, or both, of obligations of political subdivisions (as described in Section 101 (c) of this Title) or agencies and instrumentalities of States (as described in Section 101 (d) of this Title), the interest on which is subject to Federal taxation, in accordance with the Amendment made by Section 201. The Bank shall give prompt consideration to any application for a guarantee under this Title and shall,
in the event such guarantee is denied, set forth the reasons for such a denial in a written statement copies of which shall be furnished to the Governor of the State whose political subdivision or instrumentality has applied for such guarantee, the chief elected official of the political subdivision, the Committee on Banking, Housing and Urban Affairs of the Senate, and the Committee on Banking, Finance and Urban Affairs of the House.

Section 113--Purpose

The Bank may make guarantees under this Title only for the purpose of--

(1) enabling a political subdivision or agency or instrumentality of a State to continue to provide essential public services and facilities; or

(2) preventing, or mitigating the effects of, a default in the payment of obligations of a political subdivision of a State where such a default has had, or, in the judgment of the Bank, could reasonably be expected to have, a serious adverse effect on general economic conditions or on the marketability of obligations of States and their political subdivisions in general.

Section 114--Conditions of Eligibility

(a) The Bank may exercise its power of guarantee under Section 112 of this Title on behalf of any political
subdivision or instrumentality of a State that is effectively unable to obtain credit in the private market, at acceptable interest rates (as defined in Section 101 (i) of this Title) in amounts sufficient to meet its financial needs.

(b) The Bank may exercise its powers of guarantee only on behalf of a political subdivision or instrumentality of a State that submits, in such detail and in accordance with such accounting principles as the Bank may prescribe:

   (1) data demonstrating that its operating expenses are in balance with its recurring revenues; or

   (2) a plan for bringing its operating expenses into balance with its recurring revenues for its second full fiscal year following its initial application for a guarantee, and thereafter for as long as such guarantee is required and desired.

(c) A guarantee may be made under this Title only if the Bank determines that there is reasonable prospect of repayment of the obligations to be guaranteed in accordance with their terms and conditions. In making the guarantee, the Bank may require such terms and conditions as it may deem appropriate to insure repayment, including:

   (1) joint and several responsibility by the State for the guaranteed obligations; and

   (2) the establishment of a financing agent by the State to act on behalf of and be responsible for the
fiscal transactions of the applicant political subdivision or agency or instrumentality of a State. The Bank is authorized to agree to any modification, amendment, or waiver of any such term or condition as it deems desirable to protect the interests of the United States.

(d) No guarantee shall be provided under this Title unless (A) the political subdivision, instrumentality, or its financing agent shall have repaid according to their terms all prior guaranteed obligations under this Title which have matured, and (B) the political subdivision, agency or instrumentality, or financing agent is in compliance with the terms of any such outstanding obligations.

Section 115—Security for Guarantee

In connection with any guarantee under this Title, the Bank may require the political subdivision, agency, instrumentality, any financing agent, and where it deems necessary, the State, to provide such security as it deems appropriate. The Bank may take such steps as it deems necessary to realize upon any collateral in which the United States has a security interest pursuant to this section to enforce any claim the United States may have against the political subdivision, instrumentality or any financing agent pursuant to this Title. Notwithstanding any other provision of the law, Acts making appropriations may provide for the withholding of any payments
from the United States to the political subdivision or instrumentality, either directly or through the State, which may be or may become due pursuant to any law and offset the amount of such withheld payments against any claim the Bank may have against the political subdivision, instrumentality, or any financing agent pursuant to this Title. With respect to debts incurred pursuant to this Title, for the purposes of Section 3466 of the Revised Statutes (31 U.S.C. 191) the term "person" includes the political subdivision, instrumentality, or any financing agent.

Section 116--Guarantee Fees

Whenever any obligation is guaranteed under this Title, the Bank shall assess and collect from the obligor a guarantee fee which shall not exceed three-quarters of one percent per annum.

Section 117--Inspection of Documents

At any time a request for a guarantee is pending or obligations are outstanding under this Title, the Bank is authorized to inspect and copy all accounts, books, records, memorandums, correspondence, and other documents of the political subdivision, instrumentality or any financing agent relating to its financial affairs.

Section 118--Audits

No guarantee may be made under this Title for the benefit of any political subdivision or agency, or instrumentality
unless the General Accounting Office is authorized to make such audits as may be deemed appropriate by either the Bank or the General Accounting Office of all accounts, books, records, and transactions of the State, the political subdivision and, if involved, any agency or instrumentality of such State or a political subdivision. The General Accounting Office shall report the results of any such audit to the Board and to Congress.

Section 119--Authorization for Guarantees

To carry out the purposes of Section 112 of this Title, the Bank is authorized to guarantee obligations of political subdivisions, agencies and instrumentalities of States and any financing agents up to the amount of $10,000,000,000. At no time shall the Bank have guarantees totaling more than this amount outstanding. The authority to issue such guarantees shall go into effect immediately upon enactment of this Title.

Section 120--Loans to Commerce and Industry

The Bank may make or guarantee loans or purchase obligations to provide funds for the purchase of real and personal property and for working capital necessary for the location of new business and industry, or the improvement of existing business and industry in depressed urban and rural areas as defined by Section 101 (f) of this Act, as well as to prevent the outmigration of business and industry out of depressed urban and rural areas.
Section 121--Loans for Community Development

The Bank may make or guarantee loans or purchase obligations or guarantee the payment of principal and interest on obligations to finance capital expenditures for public works and community facilities, including facilities for education, health, social welfare, recreation, sewer and water systems, land for housing development, public transportation, and utilities, providing that such facilities and projects extend direct and substantial benefits to urban slum and depressed rural areas, or provide other benefits specified by the Bank to carry out the purposes of this Title.

Section 122--Loans for Low- and Moderate-Income Housing

The Bank may make or guarantee loans to appropriate public agencies, nonprofit cooperatives and corporations, limited dividend corporations, developers, contractors, subcontractors, and other persons to provide construction loans for housing projects designed to provide dwellings under the insured and guaranteed low- and moderate-income housing loan programs of the Department of Housing and Urban Development, the Veterans' Administration, and the Farmers Home Administration of the Department of Agriculture.

Section 123--Technical and other Assistance

(a) The Bank may provide to borrowers whatever assistance, technical or otherwise, it considers necessary to protect its investment and to carry out the purposes of this Title.
(b) To assure the carrying out of the purposes of this Title, the Bank shall direct an adequate number of staff members to seek out and confer with representatives of States and local governments, public agencies, nonprofit private organizations, companies, corporations, partnerships, and individuals, in order to provide information about the services furnished by the Bank, to provide whatever assistance is necessary for utilization of such services, and to assist the recipients of such services in meeting other requirements laid down by the Bank to carry out the purposes of this Title.

Section 124--Security Required

The Board of Directors of the Bank shall make whatever arrangements it considers adequate to secure loans made by the Bank.

Section 125--Maturity of Loans

Loans made by the Bank to any state and local government, private corporation, company, or individual under Sections 120, 121 and 122 of this Title, shall be for periods determined by the Board of Directors of the Bank, bearing in mind that the maturity of such loans should, whenever possible, coincide with the projected useful life of the facilities financed with such loans. However, the outstanding balance due on Bank loans shall be refinanced through another lender whenever, in the judgement of the Board of Directors, such refinancing is feasible on terms and conditions which the Board of Directors considers to be reasonable for the borrowers.
Section 126--Guaranteed Loans

The Bank may fully guarantee the entire interest and principal of any loan made by any bank, savings bank, trust company, building and loan or savings and loan association, insurance company, mortgage loan company, or credit union, provided that such loans are made to carry out the development purposes of this Title and the effective interest rate for such loans is not more than 1 ½ per centum above the Federal Reserve Discount rate.

Section 127--Direct Loans

To carry out the development purposes of this Title, the Bank may make direct loans to State and Local governments, public agencies, nonprofit private organizations, corporations, companies, partnerships, and individuals providing that the effective interest rate does not exceed the Federal Reserve discount rate, or a lesser rate established by the Board of Directors of the Bank, provided that borrowers have presented evidence that they are unable to obtain funds on reasonable terms from any other source to carry out the purposes of this Title.

Section 128--Taxable Status

The Bank, its property, its franchise, capital, reserves, surplus, security holdings, and other funds, and its income shall be exempted from all taxation now or hereafter imposed by the United States or by any State or local taxing authority;
except that (1) any real property and any tangible personal property of the Bank shall be subject to Federal, State and local taxation to the same extent according to its value as other such property is taxed, and (2) any and all obligations issued by the Bank shall be subject both as to principal and interest to Federal, State, and local taxation to the same extent as the obligations of private corporations are taxed.

Section 129--Audit by the General Accounting Office

The General Accounting Office shall audit the financial transactions of the Bank, and for this purpose shall have access to all its books, records, and accounts.

Section 130--Authorization of Appropriations

(a) There is authorized to be appropriated, without fiscal year limitation, the sum of $4,000,000,000, to the Secretary of the Treasury to finance the purchase of Bank stock.

(b) There are authorized to be appropriated, without fiscal year limitation, such sums as may be necessary to pay the difference, if any, between the interest paid by the Bank on its obligations and interest received by the Bank on its loans, and to reimburse the capital of the Bank to the extent of any defaults, and such additional sums as may be necessary to establish and operate the Bank and otherwise carry out the purpose of this Title.
TITLE II--AMENDMENT TO THE INTERNAL REVENUE CODE OF 1954

Section 201--Taxability of Certain Federally Guaranteed Obligations

Section 103 (a) (1) of the Internal Revenue Code of 1954 (relating to interest on certain governmental obligations) is amended by inserting immediately before the semicolon at the end thereof the following: " , except in the case of an obligation whose payment is guaranteed in whole or part under authority of Section 112 of the National Development Act of 1977".
H.R.

IN THE HOUSE OF REPRESENTATIVES

Mr. Badillo introduced the following bill; which was referred to the Committee on _________

A BILL

To extend the authority of the Secretary of the Treasury to make loans under the New York City Seasonal Financing Act of 1975 for a period of three years.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 11 of the New York City Seasonal Financing Act of 1975 is amended by striking out "1978" and inserting in lieu thereof "1981".
17 November 1976

Mr. David Herships
United States Treasury Department
1325 G Street, N.W. (Room 720)
Washington, D. C. 20005

Dear Mr. Herships:

We are enclosing, for your information, two copies each of the following documents:

(1) the Corporation's enabling legislation (Chapters 168, 169, Laws of 1975, State of New York);

(2) Series A Official Statement, July 1, 1975 (First Resolution Bonds);

(3) Series B Official Statement, August 1, 1975 (First Resolution Bonds);

(4) Series 1-4 Official Statement, November 26, 1975, and Supplement, December 16, 1975 (Second Resolution Bonds, First Exchange Offer);

(5) Series 5 Official Statement, May 21, 1976, and Series 6 Supplement, June 29, 1976 (Second Resolution Bonds, Second Exchange Offer); and

(6) the Corporation's first Annual Report.

These Official Statements comprise all of the Corporation's Official Statements for exchange offerings under its Second General Bond Resolution, and, together with the 1976 Series CC prospectus which we sent to you last
week, the Corporation's Official Statements for its principal publicly traded issues under the First General Bond Resolution.

I hope that this material will be helpful to you. If you would like any further information, please let us know.

Sincerely,

Stephen J. Weinstein
Deputy Executive Director

Enclosures (12)

SJW/mp
Mr. Felix G. Rohatyn, Chairman
Municipal Assistance Corporation
for the City of New York
Two World Trade Center
New York, New York 10047

Dear Mr. Rohatyn:

At the request of our client, the Secretary of the Treasury, we are enclosing a copy of our report dated June 23, 1976, regarding information relating to the financing requirements under the New York City Seasonal Financing Act of 1975.

Very truly yours,

ARTHUR ANDERSEN & CO.

Enclosure
STAFF MEMORANDUM

on

NEW YORK CITY'S PROGRESS

UNDER THE

NEW YORK CITY SEASONAL FINANCING ACT OF 1975
(P.L. 94-143)

Subcommittee on Economic Stabilization

of the

Committee on Banking, Currency and Housing
U.S. House of Representatives

July 20, 1976
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</tr>
</tbody>
</table>
INTRODUCTION

The House Committee on Banking, Currency and Housing, under its jurisdiction over "Financial aid to commerce and industry (other than transportation)" (Rule X(d)(7) of the Rules of the House of Representatives), has oversight responsibility for the New York City Seasonal Financing Act of 1975 (Public Law 94-143). The legislative oversight of Public Law 94-143 has been referred by Committee Chairman Reuss to the Subcommittee on Economic Stabilization.

Upon assumption of the Chairmanship of the Subcommittee on Economic Stabilization, the Honorable William S. Moorhead requested Subcommittee staff to intensify its oversight of the New York City Seasonal Loan program, and to report to the Subcommittee. Accordingly, majority staff members Ruth M. Wallick and Charles K. Stein, and minority staff member Lawrence I. Feldman, conducted interviews on June 16, 17, 18, 21, 22 and 24 with the following individuals:

Kenneth Axelson, Deputy Mayor for Finance, New York City;

Stephen Berger, Executive Director, Emergency Financial Control Board;

Michael Curley, Deputy Commissioner and Counsel, New York State Department of Commerce;
Herbert Elish, Executive Director, Municipal Assistance Corporation;

William M. Ellinghaus, President, New York Telephone Co. and Member, Emergency Financial Control Board;

Robert A. Gerard, Assistant Secretary, Capital Markets and Debt Management, U.S. Department of the Treasury;

Victor Gotbaum, Executive Director, District Council 37, American Federation of State, County and Municipal Employees, New York;

Edward Hefferson, New York City Project Manager, General Accounting Office;

Donald Kummerfeld, Director, New York City Office of Management and Budget;

Arthur Levitt, Comptroller, State of New York;

Victor Marrero, Chairman, New York City Planning Commission;

Robert Rivel, President, Dime Savings Bank and Chairman, Mayor's Contingency Committee;

Felix Rohatyn, Partner, Lazard Freres and Co., and Chairman, Municipal Assistance Corporation;

Sidney Schwartz, Special Deputy Comptroller for the City of New York;

Richard R. Shinn, President, Metropolitan Life Insurance Co., and Chairman, Mayor's Management Advisory Board;

John Zuccotti, First Deputy Mayor, New York City.

Staff members also attended a special meeting of the Emergency Financial Control Board called to consider a request by the Secretary of the Treasury
for the Board's evaluation of several areas of concern relating to the City's fiscal 1977 expense budget and the Three-Year Financial Plan. On an ongoing basis, staff has attended the periodic briefings on the New York loan program given by Assistant Secretary Gerard, and has, since the enactment of Public Law 94-143, continuously reviewed and analyzed the reports, critiques and other documents relating to New York City's fiscal situation which have been prepared by a variety of agencies and organizations, both public and private.
I. BACKGROUND

New York City Fiscal Crisis - 1975.-- In the spring of 1975, New York City began to encounter difficulties in obtaining financing in the credit markets to carry itself through periods of cash flow shortages. In June 1975, the State Legislature created the Municipal Assistance Corporation (MAC) to market the City's obligations backed by the "moral obligation" of the State. When MAC's bond issues met resistance, the Legislature in September enacted the New York State Financial Emergency Act, which created the Emergency Financial Control Board, and the Special Deputy State Comptroller for New York City. The Board's responsibilities include approval of a Financial Plan to balance the City's budget by the end of fiscal year 1978, and monitoring the City's progress in meeting that goal.

New York City Seasonal Financing Act of 1975.-- In December 1975, Congress enacted, and the President signed, Public Law 94-143, the New York City Seasonal Financing Act. The Act provides for short-term loans by the Federal Government to the City to cover periods of cash shortfall. The City may borrow up to $2.3 billion in a fiscal year, at an annual interest rate of 1 percent greater than the interest rate paid by the Federal Government. All of the loans are to be repaid by the end of the fiscal year during which the loans were made. The loan program is to expire at the end of fiscal year 1978.

The program is administered by the Secretary of the Treasury. Before making any loan to the City, the Secretary must determine that there is a "reasonable prospect of repayment of the loan."
Credit Agreement.-- On December 30, 1975, the Department of the Treasury entered into a credit agreement with the City, the State of New York, the Emergency Financial Control Board and the Municipal Assistance Corporation.

The principal requirements of the Credit Agreement are:

--Certification by the Emergency Financial Control Board that loans requested are consistent with the City Financial Plan;

--Agreement by the Mayor, City Comptroller, and Control Board to take all actions necessary to insure that revenues securing repayments are paid into a special repayment account, controlled by the Secretary of the Treasury;

--Power to require the Governor and State Comptroller to prevent disbursement of State-funded repayment revenues, except to the Secretary of the Treasury;

--Submission of detailed analyses on a regular basis to provide the flow of information needed to track and monitor the City's performance and adherence to the Financial Plan and Credit Agreement;

--Right to audit and inspect the books and records of New York City and New York State.

Fiscal Year 1976 Loans. In fiscal year 1976, the Federal Government loaned New York City $1.26 billion. The schedule of loans, with repayment dates and amount of interest, follows:
<table>
<thead>
<tr>
<th>Date of Loan</th>
<th>Amount</th>
<th>Interest Rate</th>
<th>Repayment Date Scheduled</th>
<th>Repayment Date Actual</th>
<th>Interest Paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/18/75</td>
<td>$130,000,000</td>
<td>6.92%</td>
<td>4/20/76</td>
<td>4/16/76</td>
<td>$5,120,724</td>
</tr>
<tr>
<td>12/31/75</td>
<td>240,000,000</td>
<td>6.68%</td>
<td>5/20/76</td>
<td>5/18/76</td>
<td>6,105,337</td>
</tr>
<tr>
<td>1/15/76</td>
<td>140,000,000</td>
<td>6.13%</td>
<td>4/20/76</td>
<td>4/16/76</td>
<td>(A)</td>
</tr>
<tr>
<td>2/11/76</td>
<td>250,000,000</td>
<td>6.29%</td>
<td>6/20/76</td>
<td>6/18/76</td>
<td>5,514,421</td>
</tr>
<tr>
<td>2/17/76</td>
<td>180,000,000</td>
<td>6.26%</td>
<td>6/30/76</td>
<td>(B)</td>
<td>8,085,189/a</td>
</tr>
<tr>
<td>3/1/76</td>
<td>250,000,000</td>
<td>6.39%</td>
<td>6/30/76</td>
<td>(B)</td>
<td>2,298,192/b</td>
</tr>
<tr>
<td>3/15/76</td>
<td>70,000,000</td>
<td>6.33%</td>
<td>6/30/76</td>
<td>(B)</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$1,260,000,000</strong></td>
<td></td>
<td></td>
<td><strong>$27,123,963</strong></td>
<td></td>
</tr>
</tbody>
</table>

(A) Interest on this loan is included in the $5,120,724 interest payment shown for the 12/18/75 loan.

(B) $400,000,000 was repaid on 6/25/76, and $100,000,000 was repaid on 6/30/76.

/a represents interest on $400,000,000

/b represents interest on $100,000,000
II. 3-YEAR PLAN

Actions taken by the City and State to Reduce the Deficit.

New York City began implementing the 3-year Financial Plan in fiscal year 1976, with planned expenditure reductions of $92 million, resulting in annualized savings of $200 million. Whether this goal was met will not be known until the Deputy State Comptroller completes his review in the next month or six weeks.

Illustrative of actions taken by the City to reduce spending are the following:

---Reducing the City's payroll. A statement issued by Budget Director Donald Kummerfeld on March 10, 1976, indicated that between December 31, 1974 and February 29, 1976, the full-time payroll had been reduced by 44,275. On December 31, 1974, there were 294,522 full-time employees on the City payroll. As of February 29, 1976, the figure was 250,247. The most significant reductions are as follows:

<table>
<thead>
<tr>
<th>Agency</th>
<th>No. of Positions</th>
<th>% of Agency Positions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Police</td>
<td>4,679</td>
<td>13.7</td>
</tr>
<tr>
<td>Fire</td>
<td>1,926</td>
<td>13.7</td>
</tr>
<tr>
<td>Sanitation</td>
<td>2,612</td>
<td>18.2</td>
</tr>
<tr>
<td>DOSS</td>
<td>3,815</td>
<td>14.2</td>
</tr>
<tr>
<td>PRCA</td>
<td>1,097</td>
<td>23.3</td>
</tr>
<tr>
<td>Board of Education</td>
<td>11,116</td>
<td>13.9</td>
</tr>
<tr>
<td>Board of Higher Education</td>
<td>2,208</td>
<td>11.0</td>
</tr>
<tr>
<td>HHC</td>
<td>8,130</td>
<td>17.3</td>
</tr>
</tbody>
</table>

---City University of New York. When the City University refused to make expenditure cuts, as requested by the City, the Mayor in late May 1976, refused to advance funds to enable the University to meet its payroll, forcing the closing of the University and the resignation of three Board of Higher
Education members. Shortly thereafter, the newly appointed Board members voted to impose tuition for the first time in the system's 129-year history.

--Wages and Fringe Benefits. A May 1976 Emergency Financial Control Board resolution, triggered by the Transit Workers settlement calling for cost-of-living increases, mandated that collective bargaining agreements provide no increases in wages, salaries or fringe benefits, and that any cost-of-living increases be realized through accompanying savings achieved by gains in productivity, reduction in fringe benefits, or other savings or revenues approved by the Board. An "agreement in principle" adhering to this policy, and applying the policy to a planned $24 million cut in fringe benefits in the fiscal year 1977 budget, was reached with representatives of 130,000 city workers whose contracts were due to expire on June 30, 1976.

According to a report on pensions of the Mayor's Management Advisory Board, (known as the "Shinn Report" named for Richard Shinn, Chairman of the Advisory Board), the following items should be successfully negotiated through collective bargaining:

--The current level of employee contributions should be increased by $94 million annually; and

--Heart disability benefits that cost $17 million annually should be ended.

However, since the City actuary has already certified the contribution for 1977 and the Shinn Report recommends a phase-in of higher pension costs, the forecasted cash flows
for 1977 should not be affected.

New Accounting System.— It has been widely noted that New York City's accounting and financial control systems have been fraught with inadequacies. These inadequacies included the absence of:

--an encumbrance accounting system, the lack of which results in an inability to accurately assess the financial impact of overall expense commitments versus budgeted amounts;

--a personnel control system, without which the impact of personnel reductions cannot be accurately assessed;

--an agency cash allocation and monitoring system, which would more closely control the spending practices and cost reduction programs by agency; and

--a Federal and State aid reimbursement tracking system, to more accurately forecast cash flow and receipt of revenue.

In recognition of this, the City Comptroller initiated a program to revise these systems. This program, jointly sponsored by the Mayor and the Comptroller, has as its objective, the development of a uniform accounting system approved by the New York State Comptroller to be implemented effective July 1, 1977. Additionally, the MAC legislation requires an audit of the City's financial statements as of June 30, 1978.

According to City officials, the encumbrance system will be initially introduced, on a manual basis, into five major agencies and covered organizations where the majority of the City expenditures occur. Implementation of the payroll subsystem, part of the large-scale Integrated Financial Management System, has been delayed from July 1977 to December 1977.

In testimony before the U.S. Senate Committee on the District of Columbia on June 28, 1976, Mr. Fred M. Oliver,
Government Accounting Specialist and consultant to the New York State Department of Audit and Control, stated that not all of the accounting system revisions would be in place on schedule.

Mr. Oliver stated:

"The MAC legislation provides now that they should attempt to audit...as of June 30, 1978. I am sure...that by that date, it would not be possible for the financial statements (of New York City) to...be in performance with generally accepted accounting principles.

There are already delays in significant segments of the system which have been designed, but will put it off at least two years."

Mr Oliver pointed out that the amendments to the New York City Charter, which provided for the revisions of the accounting system in total, allowed five years, to 1981, for total accomplishment. Mr. Oliver's statement concerning this point was,"They probably might well be more accurate than is the mandated or expressed date in the MAC legislation."

**Monitoring the City's expenditures.** Beginning July 1, 1976, a new monitoring system provides for quarterly allocation of funds to the mayoral agencies, and for monthly reporting of expenditures by the agencies to the City's Office of Management and Budget. The Budget Director thus expects to be able not only to monitor each agency's adherence to its budget, but to hold agency heads responsible for conforming to quarterly allocations.

**Tax Adjustments.** In late November 1975, the Department of the Treasury was presented with a financing plan that met the City's requirements. The package included the following elements:

---New and increased taxes designed to yield $500 million during the period December 1, 1975 through June 30, 1978.
Included were higher taxes on personal income, increased bank, estate and cigarette taxes, an increase in the minimum corporate income tax and extension of the sales tax to cover personal services.

--- Increased real estate taxes designed to yield $400 million.

Action was taken by the New York State legislature on November 26, 1975, which resulted in a new tax package for New York City, as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increased Financial Corporation Tax due to increased rate and elimination of</td>
<td>$45</td>
</tr>
<tr>
<td>certain deductions</td>
<td></td>
</tr>
<tr>
<td>Increased Personal income taxes due to increased rate</td>
<td>$75</td>
</tr>
<tr>
<td>Establishment of minimum personal income tax on preference items and minimum</td>
<td></td>
</tr>
<tr>
<td>general corporation tax</td>
<td>$15</td>
</tr>
<tr>
<td>Doubling of cigarette tax rate and elimination of tar and nicotine tax</td>
<td>$15</td>
</tr>
<tr>
<td>Extended sales tax coverage</td>
<td>$15</td>
</tr>
<tr>
<td>Effect of City surcharge on State estate tax</td>
<td>$35</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>$200</strong></td>
</tr>
</tbody>
</table>

Forecasted collections of these taxes are $85 million in FY 1976, $200 million in 1977 and $200 million in 1978.

Additionally, on June 22, 1976, the City Council of New York approved a real estate tax increase of 60.8 cents, raising the rate to $3.795 for each $100 of assessed valuation.

There have been other tax adjustments along with the new taxes outlined above. In late June 1976, State legislation was enacted allowing Wall Street securities dealers to take a full tax credit for stock transfer taxes they pay on market making transactions. This will result in a $42 million a year tax break granted to the brokers. Other adjustments include the repeal of the bond transfer and estate taxes.
Monitors of the Financial Plan.-- The New York City Seasonal Financing Act (P.L. 94-143) provides for the General Accounting Office's access to the records of both the State and City of New York and provides flexibility on the type and frequency of audits and reports to the Congress. Others involved in monitoring the City's financial situation include the following:

---City officials in the Mayor's Office, Comptroller's office and Management and Budget office are the internal monitors of compliance with the financial plan. They gather basic data and prepare the reports submitted to the Emergency Financial Control Board and the Treasury Department.

---The Emergency Financial Control Board, in addition to its other functions, is the primary external monitor in that it critically assesses the data prepared by the City. The Board is assisted in this work by the Special Deputy State Comptroller and his staff of about 50 professionals, most of whom are accountants and auditors. The Special Deputy State Comptroller works closely with the Board and reports on the City's progress and compliance with the Plan.

In addition, a separate group of about 85 auditors, as a part of the normal audit function of the Office of the State Comptroller, are auditing City operations. For a number of years, this group has been assigned to audits of various agencies of the City on a continuing basis. Their work is not directly and solely related to the current crisis but it does supplement the effort of the Special Deputy State Comptroller to some degree.
Over and above these efforts, the Secretary of the Treasury has responsibility for administering the provisions of the Seasonal Financing Act. He is authorized access to all accounts and other City records and is required, among other things, to determine that there is a reasonable prospect of repayment before loans are made. Treasury has been assisted by the CPA firm of Arthur Andersen and Co., which it initially engaged to provide an overview report on information relating to financial requirements under the Act. This was accomplished in late December 1975. As an outgrowth of this effort, Treasury presently gets a package of 13 reports from the City on a monthly basis. These reports are designed to provide a picture of the City's progress against its plan.

While Arthur Andersen and Co. continued to provide assistance to the Treasury through June 30, 1976, a special Treasury office, known as the Office of New York City Finance, is being established. Treasury officials expect to have approximately 5 professional staff members in Washington, D.C., and 4 in New York City. The New York City office is expected to perform specific audits and reviews beginning around the end of July.
### III. CHARACTERISTICS OF THE PLAN

#### A. Revenue Projections

As part of its Financial Plan, New York City officials estimated its revenue for each of the 3 fiscal years in the plan. Major categories of revenue are General Fund, Real Estate Taxes, State and Federal Aid, and Other. The following table shows the current revenue forecasts, by category, as adopted by the EFCB on June 23, 1976, for each of the 3 fiscal years.

---

**NEW YORK CITY FINANCIAL PLAN**  
**REVENUE PROJECTION**  
**As Approved by the EFCB on 6/23/76**

<table>
<thead>
<tr>
<th></th>
<th>FY 1976 (Dollars in millions)</th>
<th>FY 1977</th>
<th>FY 1978*</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>General Fund:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Utilities Tax</td>
<td>100</td>
<td>105</td>
<td>116</td>
</tr>
<tr>
<td>Sales tax</td>
<td>823</td>
<td>851</td>
<td>910</td>
</tr>
<tr>
<td>Stock transfer tax</td>
<td>235</td>
<td>230</td>
<td>198</td>
</tr>
<tr>
<td>Personal Income tax</td>
<td>592</td>
<td>697</td>
<td>740</td>
</tr>
<tr>
<td>Corporate Income tax</td>
<td>446</td>
<td>480</td>
<td>492</td>
</tr>
<tr>
<td>Commercial Rent tax</td>
<td>200</td>
<td>208</td>
<td>216</td>
</tr>
<tr>
<td>Financial tax</td>
<td>228</td>
<td>174</td>
<td>205</td>
</tr>
<tr>
<td>Sundry revenues</td>
<td>25</td>
<td>20</td>
<td>16</td>
</tr>
<tr>
<td>Bond transfer tax</td>
<td>10</td>
<td>-0-</td>
<td>-0-</td>
</tr>
<tr>
<td>CBT</td>
<td>60</td>
<td>60</td>
<td>61</td>
</tr>
<tr>
<td>Cigarette tax</td>
<td>51</td>
<td>59</td>
<td>59</td>
</tr>
<tr>
<td>Estate tax</td>
<td>-0-</td>
<td>-0-</td>
<td>35</td>
</tr>
<tr>
<td>State Revenue Sharing</td>
<td>434</td>
<td>472</td>
<td>511</td>
</tr>
<tr>
<td>Federal Revenue Sharing</td>
<td>263</td>
<td>275</td>
<td>261</td>
</tr>
<tr>
<td>Other</td>
<td>511</td>
<td>549</td>
<td>556</td>
</tr>
<tr>
<td><strong>Real Estate Tax</strong></td>
<td>2967</td>
<td>3206</td>
<td>3283</td>
</tr>
<tr>
<td><strong>State &amp; Federal Aid</strong></td>
<td>4709</td>
<td>4260</td>
<td>4486</td>
</tr>
<tr>
<td><strong>Other</strong></td>
<td>381</td>
<td>413</td>
<td>193</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>12035</td>
<td>12064</td>
<td>12338</td>
</tr>
</tbody>
</table>

*FY 1978 figures have not been submitted yet. These figures are based on 3/26/76 approved revisions of the Financial Plan. (FY 1978 will be revised by 8/1/76)*
MAC Takeout.-- Debt service on MAC bonds issued under the First General Bond Resolution of the Corporation adopted July 2, 1975, is paid from revenues received by the Corporation from the Sales Tax and Stock Transfer Tax. These Bonds are different from the Bonds issued under the Second General Bond Resolution in December 1975 in exchange for certain notes of the City of New York. Under this Second Resolution, debt service is to be paid from revenues received by the Corporation from Per Capita State Aid, and from the Sales Tax and Stock Transfer Tax only on a subordinated basis to the Bonds issued under the First Resolution and to the outstanding notes of the Corporation. According to Mr. Herbert Elish, Executive Director of MAC, the uncollected State Aid, and the secondary claim on Sales Tax and Stock Transfer Tax, totals 9 times the amount of debt service on MAC Bonds.

Status of Projections.-- According to Mr. Robert Gerard, Assistant Secretary of the Treasury for Capital Markets and Debt Management, Arthur Andersen and Co. has reviewed New York City's fiscal 1976 revenue figures. That review has estimated that the City will fall short of its revenue projections by approximately $110 million.

B. Expenditures

In order for New York City to achieve a balanced budget by the end of fiscal 1978, sizeable reductions in expenditures have to be attained. As of July 1, 1976, the fiscal 1977 budget deficit is projected to be $686 million. The current New York City Financial Plan, as adopted by the EFCE on June 23, 1976, shows the following cumulative expenditure reductions to be achieved in each of the 3 fiscal years in the Plan:
FY 1976    FY 1977    FY 1978
$92 million  $548 million  $1,112 million

An additional $85 million in standby cuts for FY 1977 will be formulated by the City and submitted to the EFCB by August 15, 1976.

The current modified Financial Plan is the third version adopted by the EFCB since the original on October 20, 1975. The second expenditure reduction Plan adopted by the Board was on March 26, 1976. Since the original Plan, the amount of expenditure reductions required in each of the three fiscal years has steadily increased as follows:

--Cumulative Expenditure Reductions--

<table>
<thead>
<tr>
<th></th>
<th>FY 1976</th>
<th>FY 1977</th>
<th>FY 1976</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oct. 20, 1976</td>
<td>$92 million</td>
<td>$462 million</td>
<td>$724 million</td>
</tr>
<tr>
<td>Mar. 26, 1976</td>
<td>92 million</td>
<td>513 million</td>
<td>1,062 million</td>
</tr>
</tbody>
</table>
IV. BERGER REPORT AND GAO CONCERNS

Arthur Andersen and Co. has examined New York City's fiscal 1976 expenditures and believes that the City has over expended its budget by $100-150 million. This fact was anticipated by the Executive Director of the RFCB in his June 3, 1976, report to the Control Board. In that report, Mr. Berger recommended that the City prepare a program of an additional $150 million in alternative cuts during fiscal year 1977. He suggested that these cuts be implemented as follows:

---$75 million on July 1, and
---$75 million to be phased in as the need is determined by the Board.

Based on the recommendations made by Mr. Berger in this report, the Control Board adopted a resolution on June 23, 1976, agreeing with the City that the following measures be taken:
--By July 31, 1976, a standby program of $135 million in alternative cost reductions or revenue measures will be submitted to the Control Board by the City;

--By August 15, 1976, the City will implement $50 million of these alternative cost reductions that will yield at least $35 million of cash savings during FY 1977;

--Representatives of the City, the Control Board, the Special Deputy Comptroller and MAC will agree upon a method for monitoring actual revenues and expenditures of the City during FY 1977 and for implementing other alternative reductions or revenues as necessary;

--By January 1, 1977, the City will submit a reduction program for FY 1978 to eliminate the estimated deficit. It will include a time phased implementation plan identifying these savings, all of which will be in place by July 1, 1977.

The Control Board took this action because of what Mr. Berger considered "serious flaws" in the City's plans for controlling expenditures. These include the following:

--The City has counted heavily on expenditure reduction measures that are either not feasible or that depend on State or Federal actions to relieve the City of costs for which it is currently responsible. According to Mr. Berger's report, the City's proposal for State assumption of Courts and Probation is illustrative of this problem. This proposal would require the State to assume the cost of these functions effective April 1, 1977, saving the City $24 million. At this point, the State Legislature has shown no willingness to act on this proposal. If the State does not assume these costs, Mr. Berger stated that the City would have to generate $97 million in additional annualized reductions in the last quarter of FY 1977 to obtain the targeted $24 million in cash savings.
--The City had not sufficiently taken into account the inevitable delays and problems that would arise in the implementation and management of cost reduction measures that are often complex and sophisticated.

(Mr. Berger feels the City had not dealt adequately with the likelihood of "slippage" although slippage had been acknowledged as a problem. For example, the Municipal Assistance Corporation identified $250 million to $300 million of potential "soft" spots and problem areas and called for the preparation of $150 million in standby reductions. The Special Deputy Comptroller estimated that $238.7 million of the reviewed proposed actions were uncertain at this point. The thrust of these analyses, according to Mr. Berger, led to the inescapable conclusion that the City must be prepared to implement additional reductions to assure that targeted savings are met.)

As previously mentioned, the Emergency Financial Control Board in its June 23, 1976, resolution, called for the City to submit a FY 1978 reduction program by January 1, 1977. This reduction program will include a time phased implementation plan identifying these savings to be fully in place by July 1, 1977.

Another level of concern stems from the relationship between the City and agencies which are known as "Covered Organizations." These include the Health and Hospitals Corporation, the Board of Education, the Board of Higher Education.

(According to Mr. Berger, almost one-third of the 1977 Financial Plan reductions involve these agencies which are beyond the direct control of the Mayor. These agencies, according to Mr. Berger, have been unable, or unwilling, to take actions necessary to meet the reductions set by the Mayor. The Board of Education, for example, has refused to provide detailed plans
to either the City Office of Management and Budget or to the Special Deputy Comptroller, for $30.9 million of the targeted expenditure reduction for FY 1977.)

GAO Concerns.-- The General Accounting Office in a report released June 28, 1976, expressed concerns over various aspects not included in the financial plan. The GAO believes that the inclusion of the following items in the plan would contribute to the City's chance of recovery.

--An arrangement for retiring the debt in moratorium.
--The additional operating deficit represented by the operating expenses included in the capital budget.
--Plans for contingencies such as a possible increase in city pension contributions, and the anticipated deficit in the New York City Transit Authority's operations.

Additionally, GAO believes the magnitude of the above factors points to the need for a city plan covering a period longer than three years. A longer plan, if properly detailed, according to GAO, should provide a more realistic view of the City's financial picture.
V. FISCAL YEAR 1977 SEASONAL LOANS

On July 1, 1976, the City requested its first fiscal year 1977 loan -- $500 million. The Department of the Treasury extended the loan, basing its determination of "reasonable prospect of repayment" essentially on two factors:

(1) The Emergency Financial Control Board's June 23, 1976, resolution requiring the City to specify by July 31, an additional $135 million in standby cuts for fiscal year 1977, and to implement $50 million of these cuts by August 15; and

(2) The "agreement in principle" that the labor contracts will be settled in a manner consistent with the Board's wage policy resolution.

The schedule of planned seasonal loans for FY 1977 follows:

<table>
<thead>
<tr>
<th>Date of Loan</th>
<th>Amount</th>
<th>Repayment Date</th>
<th>Collateral</th>
<th>Amount of Collateral</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 1</td>
<td>$500</td>
<td>Apr. 15</td>
<td>State Advance</td>
<td>$400</td>
</tr>
<tr>
<td>July 15</td>
<td>300</td>
<td>Apr. 15</td>
<td>(State Education</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(Federal &amp; State Welfare</td>
<td>180</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(Bond Sale</td>
<td>375</td>
</tr>
<tr>
<td>July 15</td>
<td>25</td>
<td>May 16</td>
<td>State Advance</td>
<td>200</td>
</tr>
<tr>
<td>Aug. 16</td>
<td>200</td>
<td>May 16</td>
<td>State Education</td>
<td>180</td>
</tr>
<tr>
<td>Sept. 24</td>
<td>50</td>
<td>May 16</td>
<td>(Federal &amp; State Welfare</td>
<td>105</td>
</tr>
<tr>
<td>Oct. 4</td>
<td>25</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oct. 4</td>
<td>75</td>
<td>June 15</td>
<td>State Education</td>
<td>180</td>
</tr>
<tr>
<td>Dec. 1</td>
<td>300</td>
<td>June 15</td>
<td>(Federal &amp; State Welfare</td>
<td>105</td>
</tr>
<tr>
<td>Dec. 15</td>
<td>150</td>
<td>June 15</td>
<td>State Advance</td>
<td>200</td>
</tr>
<tr>
<td>Dec. 15</td>
<td>150</td>
<td>June 30</td>
<td>(State Revenue Sharing</td>
<td>387</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(Less MAC</td>
<td></td>
</tr>
<tr>
<td>Jan. 4</td>
<td>200</td>
<td>June 30</td>
<td>Stock Transfer</td>
<td>32</td>
</tr>
<tr>
<td>Mar. 4</td>
<td>200</td>
<td>June 30</td>
<td>Sales Tax (Less MAC)</td>
<td>112</td>
</tr>
<tr>
<td>Mar. 31</td>
<td>50</td>
<td>June 30</td>
<td>Welfare Settlement</td>
<td>35</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Misc. General Fund</td>
<td>30</td>
</tr>
</tbody>
</table>

$7,175
VI. Post 1978

Many observers of New York City's fiscal crisis have questioned what the City's financial situation will be when the Federal loan program ends on June 30, 1978. According to the GAO, problems which may impact on the City's ability to reenter the private credit market have not adequately been recognized in the Financial Plan. Other concerns have centered around what steps the City is taking to maintain its viability after FY 1978, assuming the Financial Plan is successful and the City balances its budget.

Moratorium Debt.-- GAO has reported that about $2.6 billion in City short-term notes were outstanding toward the end of 1975. Most of the notes were scheduled to mature between December 1975 and March 1976. Since the City was unable to borrow funds to refinance the notes, the State Legislature, on November 14, 1975, passed the New York State Emergency Moratorium Act for the City, which postponed the maturity of the notes until November 1978. The Act required the City to offer its noteholders the option to convert their notes in moratorium to long-term MAC bonds.

While some noteholders protested the Legislature's action and are currently challenging its legality in the courts, some did convert to long-term MAC bonds. After the expiration of the option period, however, about
$1.961 billion in notes were still outstanding and subject to the moratorium.

An agreement was reached between the City and five of its pension funds and 11 New York clearinghouse banks to extend the repayment period on $819 million in notes which they held. Also, MAC was able to exchange an additional $139.86 million of the outstanding notes in moratorium for long-term MAC bonds between May 21 and June 20, 1976. MAC extended the exchange deadline to July 21, 1976, in an attempt to exchange $360.14 million of outstanding notes in moratorium.

If MAC is not successful in the exchange deadline extension, approximately $1 billion of outstanding notes in moratorium are due payment of the total amount in November 1978. The financial plan makes no provision for accumulating the funds necessary to repay the notes; therefore, GAO believes the existence of the debt in moratorium should be recognized in the plan along with the City's proposed method for dealing with any amounts due in 1978.

**Effect of Downgrading by Moody's.** -- The Exchange Offer by MAC between May 21 and June 20, 1976, to holders of New York City notes in moratorium was less than successful. The principal amount offered, $500 million, resulted in the exchange of only $139.86 million of City notes in moratorium exchanged for long-term MAC bonds. According to MAC officials, a significant factor causing this low level of exchange was caused by a reduction in rating by Moody's Investors Service, Inc.
On May 26, 1976, Moody's, a major bond-rating agency, announced that it had reduced its rating of certain bonds of the Corporation issued pursuant to its First General Bond Resolution from A, its third highest rating, to B, its sixth highest rating. Moody's defines bonds to which an A rating is given as ones which are of "upper medium grade" with "adequate" security of principal and interest. Bonds to which a B rating is given are defined as ones which "generally lack characteristics of a desirable investment" and with respect to which "assurance of interest and principal payments or of maintenance of the terms of the contract over any long period of time may be small."

Moody's subsequently met with representatives of MAC and on May 28, 1976, issued a second report. Some factual misstatements contained in the first report were corrected, but Moody's reaffirmed its B rating. In this second report, Moody's referred to "the potential consequences of the continuing deterioration of the City's financial position" and stated:

"We believe, however, that the whole history of municipal financial difficulties in the United States demonstrates that financial realities are overriding and we may not prudently advise investor reliance on legal protection in a state where the legislature has postponed the maturity of debt by fiat and has denied by statute a due process granted to bondholders under the State constitution."

Moody's has stood alone in its downgrading of these "First Offer" MAC bonds. Both Standard & Poor's and Fitch rating agencies have rated these bonds at levels comparable to Moody's original A rating. This same A
rating was reaffirmed by both Standard & Poor's and Fitch following the action by Moody's.

Although Moody's rating applies only to certain of the First Bonds of MAC, and not to the "Exchange Offer" bonds, MAC officials believe that Moody's action appears to have had an adverse impact on the Exchange Offer.

In testimony before the Subcommittee on Consumer Protection and Finance of the Committee on Interstate and Foreign Commerce on June 24, 1976, Mr. Jackson Phillips, Executive Vice President of Moody's, explained the lowered rating. He stated that on May 21, 1976, MAC distributed its prospectus describing a $500 million exchange offer to City noteholders. On May 26, 1976, MAC published a request for consent to two complicated amendments to its General Bond Resolution. It stated:

"Without such amendments, the Corporation could not carry out certain terms of the Agreement without being in default under the Resolution."

This statement, coupled with what Mr. Phillips characterized as "clear evidence the City's Financial Plan was not working," and other factors, caused Moody's to lower the MAC rating. In doing so, according to Mr. Phillips, Moody's was expressing its judgment, not that the City would go into bankruptcy, but simply that uncertainties and risks had intruded which did not permit a higher rating. It is Moody's hope, expressed by Mr. Phillips, that these uncertainties and risks be reduced or eliminated, thus leaving the impression that Moody's rating could be adjusted in the future.
Treasury's Interest in Post-1978.-- In a letter to the Control Board on June 16, 1976, Secretary Simon requested a Financial Plan from New York City for FY 1979. According to Assistant Secretary Gerard, this Plan should include a proposed budget consistent with the necessities for the City to meet its financing and to retire the outstanding notes of the City. Treasury expects this FY 1979 Plan to be submitted by the Control Board by December 31, 1976.

Treasury's interest in the post-1978 period centers around New York City's ability to reenter the credit markets. The Federal loan program is scheduled to end on June 30, 1978. After this period, the City will have to turn to the credit markets in the absence of the Federal loans. Should New York City achieve a balanced budget by the end of FY 1978, Treasury wants to see how the City intends to keep its budget in balance in the future, thus maintaining an open credit market.
VII. THE ISSUE OF DEFAULT AND BANKRUPTCY

Bankruptcy is defined by Webster as utter failure or impoverishment. While many officials involved with New York City's financial crisis have described bankruptcy as the worst thing that could happen, causing chaos for the City, State and nation, another group of commentators has thrown its weight behind a suggested course of immediate default and bankruptcy.

The recent passage of an amendment to Chapter IX of the Bankruptcy Act has provided the ammunition for advocates of this proposition. Thus, the question becomes: Is the best answer to New York City's problems for the City to invoke Chapter IX and declare bankruptcy?

P.L. 94-260

The passage of P.L. 94-260 on April 8, 1976, amended the Bankruptcy Act to provide for adjustment of the debts of municipalities by voluntary reorganization procedures. A systematic and orderly course of declaring bankruptcy with minimal disruption to the municipality is facilitated by the Act.

Prior to the modification, Chapter IX did not offer a practical solution to bankruptcy proceedings for cities as large as New York City. It required that a political subdivision submit a petition to commence proceedings, together with a plan which was to be backed by the acceptances of creditors holding 51% in amount of the debt affected by the plan. This provision proved to be an insurmountable precondition to a City such as New York City. It would have been virtually impossible to obtain 51% acceptance prior to filing a petition. First,
securities are issued in bearer form and thus, the class of holders and owners is mostly unascertainable. Second, the excessive amount of time required to secure the acceptances would burden any attempts to obtain the immediate relief necessary for New York City.

The new Act removes the onerous prerequisites to filing and permits a petitioner to trigger bankruptcy proceedings by merely meeting any of four conditions precedent specified in Section 84. If it fails to meet the requirement of a pre-approved plan of debt adjustment, a municipality may satisfy one of three other conditions:

a. It may show that it has negotiated in good faith and has failed to secure the concurrence of a majority to a plan of adjustment of debts; or

b. It may show that negotiation is impracticable; or

c. It may demonstrate that it fears a creditor may attempt to obtain a preference.

The practical result of the new Act is that New York City can now easily satisfy at least one of the requirements stipulated so as to benefit from the orderly bankruptcy procedures. Now that New York is able to utilize the Bankruptcy Act, the question is whether or not it should.

A. Pro-Bankruptcy Arguments

One of the foremost proponents of the view that the Act provides the best solution to New York City's problems is Howard Samuels. In an article in New York Magazine on March 15, 1976, he sharply criticized the current three-year financial plan and advocated immediate declaration of bankruptcy.
In a telephone conversation on July 14, 1976, Mr. Samuels stated that the issue presented in his article is not default, but rather the fact that there is no strategy formulated to save the City and reverse its declining economy. The savings being attained by service cutbacks are being obscured because of the increased interest costs on debt service. According to his own studies, Mr. Samuels stated that New York City's economy has declined more than 20 percent since 1969 and the end of 1976.

Mr. Samuels believes that the City must restructure its debt over a longer period of time and at lower interest rates. This, he believes, would allow the City to reduce and discard some regressive taxation policies, thus creating an atmosphere in which business and the middle class would want to remain.

The three-year plan, according to Samuels, is based on the false assumption held by business and political leaders on the Emergency Financial Control Board that the City has endless resources which will continue to yield more money as taxes are raised. The result of taxing such a sick economy will be skyrocketing interest costs, a gutted real estate and business base, and a destroyed municipal infrastructure characterized by potholes, sewer leaks, subway derailments, and other deteriorating features.

Samuels sees municipal debt restructuring as the major answer to New York's problem and Chapter IX of the Bankruptcy Act as a vehicle to accomplish this task. New York City would be able to default on its loan obligations while continuing to
administer its governmental responsibilities subject to a judge-approved long-term plan. The law would allow the City to reduce the payments of interest and principle on its debt. This would relieve the City of its debt burden which consumes $2.3 billion annually. The money could then be applied elsewhere: to halt erosion of City services, resume capital construction, and invest in economically vital projects. Such debt restructuring would also allow New York City to lessen the oppressive business taxes which are forcing many firms away from the City, depriving it of a much-needed tax base. By prudent restructuring, New York City could transfer its capital to invest in projects which would resuscitate its economy.

Samuels' position has gained support from John Kenneth Galbraith who feels that default is a far better alternative than New York's present course of cutting services. Representative Herman Badillo has led the fight in the House. The arguments favoring bankruptcy via revised Chapter IX have emphasized that the horror stories of post New York City default in the United States have been grossly exaggerated. There will be no debilitating domino effect in the financial arena and no threat of catastrophic municipal bond market collapse. Cities which are well-managed will continue to attract investors regardless of New York City's situation; where bonds exist with sound ratings, a market will continue to flourish.
This belief summons support from the circumstances of the aftermath of February 25, 1975, when New York State defaulted on a note of one of its moral obligation agencies, the Urban Development Corporation. Financial markets did not tumble nor was New York State credit destroyed. The potentially negative psychological ramifications of a New York City default have been overblown.

B. Anti-Bankruptcy Arguments

The arguments in opposition to the Samuels-Badillo use of Chapter IX bankruptcy are many. Opponents of the plan contend that the bankruptcy of New York City would have detrimental effects on every level of government both nationally and worldwide. The "ripple" or "domino" effect of New York default is a very real threat.

According to a statement by MAC staff and counsel, upon the filing of a petition, the City's ability to provide essential services is likely to be disrupted for some period of time. During this time, the responsibility for providing these services will revert to the State of New York. Given the present financial condition of the State, the need to provide essential City services might bankrupt the State as well. In that circumstance, more than $40 billion of the City, State and State agency debt would be in default, causing some 1.5 million people to be living under conditions resembling martial law.

First, the ramifications for other municipalities would be enormous, particularly in terms of the effects on municipal bond markets. Investor confidence will be destroyed so that
individuals, corporations and banks will be unwilling to risk new capital in the municipal market. The burden will be most severe on local governments when they are denied access to the credit markets on which they are dependent. Unable to fund their deficits, they will be forced to cut expenditures and services while increasing taxes. As of late 1975, 10 percent of the United States municipalities were already unable to participate in financial markets as a result of the psychological effect of the New York City default. Default by a major municipal borrower would cause a confidence crisis for all tax-exempt bonds no matter how firm the backing.

The smallest localities will be particularly hard hit. They are currently paying higher interest rates than ever before and even a 1 percent increase in the cost of local borrowing would be catastrophic. It is estimated that the result would be an additional $1.84 billion in interest charges over the eight year life of municipal bonds offered over a one year period. Cities unable to obtain needed capital will be forced to cut development programs and services, thus aggravating unemployment problems.

Second, New York City bankruptcy would have severe repercussions at the State level. The mere prospect of City default in 1975 forced New York State's rate of interest up to 8.7 percent. It is predicted that New
York State would follow closely in the City's downward trail since its own credit is inextricably tied to the financial reputation of New York City. Mr. Rohatyn has stated that bankruptcy would destroy the State's credit and its delicate plan for large-scale borrowing.

Third, the regional impact would be equally negative. The whole New York area, particularly its many satellite cities in New England, would be subjected to increased unemployment, a drastic cut in services, and a number of personal and corporate bankruptcies in the wake of a New York City default. The surrounding areas are integrally connected with the functioning of the City.

Fourth, effects would be felt at the national level. The costs to the Federal Government would be enormous by way of direct assistance to New York City, federal assumption of welfare and unemployment compensation payments which the City would be unable to meet, and lost taxes in the course of the bankruptcy proceedings. The government and the taxpayer will be forced to shoulder a substantial portion of the burden.

The immediate aftermath of default may be extremely costly to the Federal Government. Many employees may refuse to work when the City is unable to make payroll obligations. Other employees have been laid off in the past or may suffer the same fate as a result of the default. Manpower will be lacking to provide the essential
services necessary to maintain the City. In the absence of City or State ability to cope with such a problem of national emergency proportions, the Federal Government will be compelled to step in.

In March 1970, the Federal Government mobilized the National Guard to deliver mail during the mail carriers strike. The cost six years ago for 14 days totaled $2,528,749. The expense of supplying services across-the-board would be astronomical.

There is also a fear that the National Guardsmen would not do the work which they had refused to do as City employees. Where work stoppage is widespread, affecting City workers of many areas, the Guardsmen may decline to work when summoned.

The impact on the United States banking system will cause economic hardship throughout the national economy. At the most extreme, financial institutions holding maturing New York paper may collapse or withdraw their holdings and move abroad. The consequence: a contraction of liquidity throughout the economy. Even should this not transpire, the banks will sustain losses by: (a) having to deduct anticipated interest payments on New York City obligations from estimated revenues; (b) having to write off lost value of their holdings of New York City paper against their capital; or (c) being subjected to legal action by their beneficiaries claiming the bank did not minimize the risks adequately. It is estimated that 200-300 banks in the United States would be directly and seriously affected by default.
Fifth, a New York City default would hurt the United States' international monetary standing. Respect for the U.S. financial position would be severely undermined by the spectre of its largest City going bankrupt. Moreover, the collapse of municipal markets would effect interest rates and stock prices worldwide. New York City's financial stability as one of the business capitols of the world is crucial to world monetary stability.

In addition to the "ripple" effect throughout the United States and the world, opponents of New York City bankruptcy contend that the new Chapter IX will not solve New York City's problems. Contrary to Howard Samuels' assertions, simple debt restructuring would not allow debt-service money to be diverted to pay for more city services. The New York State Constitution imposes a ceiling on real estate taxes which the City can levy. New York City is currently able to raise $1.4 billion per year above the normal real estate tax levels because this revenue is spent solely on financing its long-term debt. The Constitution allows a higher percentage of real estate taxes to be collected when the revenue is tied to payment of a municipality's debt service. If New York defaults on its debts, this surplus revenue could not be applied anywhere else, such as to a program to support City services. Hence, there is a constitutional bar to effective implementation of the debt restructuring envisioned by Samuels, Badillo, et al.

The use of amended Chapter IX is also contested on the ground that the mechanism it provides is inadequate to aid a city as large as
New York City. Under the statute, a petitioner defaulting on its debt obligations may continue to administer its governmental functions subject to a court-approved plan. The intended scope of the judge's role is unclear and this uncertainty greatly disturbs the opponents of New York City bankruptcy.

Section 82 grants exclusive original jurisdiction to a Federal judge for the adjustment of the petitioner's debt. It further specifically authorizes two court functions not included in the Act's predecessor. It may (a) permit the petitioner to reject executory contracts and (b) permit the issuance of certificates of indebtedness. These powers bestow great discretionary authority on the Federal judge.

It is true that the Section also places certain limitations on the court's power. It may not interfere with any of the political or governmental powers of the petitioner, any of the property of the petitioner, or the petitioner's use or enjoyment of any income-producing property.

However, the Act does vest potentially great power in the court despite the Section 82 limits. Section 94 gives the court an ill-defined role in confirmation of plans submitted by a petitioner. The court shall confirm the plan if several conditions are satisfied, including: that the plan is fair and equitable and feasible and does not discriminate unfairly in favor of any creditor or class of creditors; that the plan complies with the provisions of this Chapter; that the offer of the plan and its acceptance are in good faith; etc. The language of "equitable and feasible", "reasonable", and "good faith" is vague and subject to judicial interpretation, and thus gives excessive discretionary power to a judge.
Therefore, Section 94 grants broad powers to the judge and Section 82 prescribes an innovative role. A federal judge may well be required to determine priorities in the course of approving any debt restructuring plan. Is a member of the judiciary sufficiently competent in municipal administration to make such decisions for a City as complex as New York City? Critics think not.

There also exist legal impediments to a smooth recovery after declaration of New York bankruptcy. A number of states issue a "legal lists" of corporations which have defaulted. Fiduciaries are prohibited from investing in those specified for a certain number of years. "Corporations" is defined to include "Municipal Corporations" and therefore investors would be foreclosed from entering the New York City municipal market. In effect, by declaring bankruptcy, the City would be postponing the time by which it could return to being a normal, flourishing market accessible to all.

Hand-tied by the various legal and financial limitations, the City will still be unable to pay its expenses post-default. Bankruptcy will not solve New York's problems of a shrinking economic base coupled with escalating service demands. The prospect for the City if it resorts to Chapter IX is not encouraging.

New York City will be unable to meet the needs of its citizens; it will face serious repercussions when its dependent and needy inhabitants are abandoned as support programs are curtailed. Furthermore, default would require the layoff of an additional 30,000 City employees and raise the unemployment rate to 20%. Translated into fiscal terms, this would result in a $100 million tax loss per month.
Declaration of bankruptcy will also accelerate the out-migration of the middle class and corporations. Comptroller Harrison Goldin and Mr. Felix G. Rohatyn predict that bankruptcy would cause more, not fewer, service cuts than under the current three-year plan. The tax base of the City will continue to be gutted as New York becomes increasingly less attractive to the middle and upper classes and businesses. Therefore, declaration of bankruptcy would only serve to perpetuate the problems which now plague New York City.

The issue of the advisability of New York City bankruptcy has polarized those parties seeking a solution to the City's problems into vocal groups for and against the proposal. However, debate is by and large a conjectural one, since a city as large and nationally vital as New York City has never before been faced with the possibility of bankruptcy. As a result, consequences of such an outcome remain highly speculative and concrete data is lacking.
VIII. ECONOMIC FUTURE OF NEW YORK CITY

The question of whether the current three-year plan provides a realistic time period for the rehabilitation of the City's fiscal situation is of the utmost importance.

Under the tight reign of the Treasury Department, the City has been meeting its responsibilities under the three-year plan. Layoffs of municipal employees and the closing of Social Service facilities have for the most part been on schedule. However, the question remains whether the City can become a viable fiscal entity when many of its essential services are being cut in such a short period of time. John Maynard Keynes, the renowned economist, once stated "A budget deficit tends to stimulate the economy and too rapid a closing of the deficit tends to depress it."

It is imperative that while the City reduces its deficit it does not curtail essential services so as to eliminate the possibility of maintaining adequate service levels and a decent quality of life for New Yorkers.

In addition, the future economic viability of the City must be assured. The required budget cuts, while reducing expenses, are also reducing many of the services which businesses require not only for the servicing of their corporate endeavors but in their ability to employ and keep their labor supply.

New York City has been losing substantial segments of its commercial and industrial community. According to the listing in the May 1976 Fortune magazine, corporate headquarters, which account for a large share of the City's office rentals and employment, numbered 90 of the Nation's 500 largest, as compared
with 130 - 140 in the 1960's. Some have announced plans to leave, among them Union Carbide with an employee force of 3,500, which plans to relocate in Danbury, Connecticut. Texaco, Texasgulf and General Host are also reportedly planning to leave New York.

Manufacturing firms have been either shutting down or moving out of New York as well. The apparel and printing industries are striking examples of this trend. In "The Outlook for State and Local Government Fiscal Performance" prepared by Roy Bahl for the Joint Economic Committee in January 1976, it is reported that between 1967 and 1972, an average of 231 non-service firms closed per month, with large manufacturing establishments shutting down at the rate of one per day.

Wholesale and retail trade has also slacked off. The New York Times reported on May 6, 1976, that retail sales in the City's large department stores, which have been running well behind the rest of the country for the last two years, rose only 3.3 percent in April of this year, over the year earlier level, while department stores in the New York metropolitan area registered an average increase of 8.6 percent for the same period.

The real estate market, which traditionally has provided New York City with an important revenue source, has been shrinking. The City Almanac for 1975 lists lease for mid-Manhattan office space rentals at $7-12 per square foot compared with $9-14 five years ago. According to a New York Times article of May 16, 1975, the City presently has 25 million square feet of unrented office space.
A consequence of the City's declining economy, of course, is an exacerbation of the unemployment rate. According to Bureau of Labor Statistics figures, New York City has lost over 500,000 jobs in the last six years, of which more than 257,000 were in the manufacturing sector, approximately 36,000 in the securities industry, and nearly 27,000 lost because of relocation of corporate headquarters and administrative offices.

In 1975, the rate of unemployment nationwide averaged 8.5 percent, while the unemployment rate in New York City averaged 10.6 percent. Over 100,000 jobs were lost in New York City during this year alone. The unemployment rate for 1976, as of February 1976, which is the latest data available, averages 8.7 percent nationwide and 11.1 percent in New York City. (New York City unemployment percentages are unadjusted for seasonal differences.)

The ration of income between New York City and the rest of the nation has shown a steady decline since 1965. The following chart shows the decreasing proportion of national income attributable to New York City.
As is apparent in this chart, New York City's income growth rate is actually declining when compared to the national income growth rate between 1965 and 1974. Expressed in terms of ratio, New York City's income accounted for .047, .042, and .035 of the Nation's income in 1965, 1970, and 1974, respectively.
Demographic changes in New York City's population have also contributed to the declining tax base. As the past few years have witnessed, an influx of rural and minority poor has been accompanying outmigration of middle- and upper-income families to the suburbs. According to the Congressional Budget Office Background Paper on New York City (October 1975), the proportion of the City's families with incomes below the nation's median income level rose from 36 to 49 percent between 1950 and 1970. And while in 1950, New York City had 61.1 percent of the metropolitan region population, by 1970, that figure was less than 50 percent. Increasingly, therefore, the City's population is comprising those who are dependent on the City's services — the poor, the uneducated, the elderly, the non-English speaking.

The result of this trend, of course, is that New York City's tax base has failed to grow at the same rate as its revenue demand.

Concern over this trend is great; solutions are not readily discernible. New York City's leaders, both governmental and private, recite the need for new and different policies at all levels — Federal, State and local. Federal policies, they believe, have fostered economic growth in other regions of the country at the expense of the Northeast. The tax burden in New York City has created a major disincentive to businesses staying in the City, not to mention locating there. Services are deteriorating, and the overall quality of life is worsening. Once set in motion, these developments become self-perpetuating and compound one another. Little relief appears to be in sight.
SUMMARY OF FINDINGS

1. New York City has weathered the first year of its three year plan for financial recovery. All of the Federal seasonal loans for fiscal year 1976 were repaid on or before schedule, including interest.

2. Although it is questionable whether New York City has achieved its goals for the first year of the Financial Plan, significant actions have been taken in an attempt to reduce the deficit. These actions have included (a) reductions in the City's payroll, (b) the imposition of a tuition at the City University of New York for the first time in 129 years, (c) the reaching of an "agreement in principle" between the City and its labor unions on controlling wages and cost-of-living increases and the reduction of fringe benefits, (d) the initial development of new accounting and financial control systems, and (e) the adjustment of certain taxes. Monitoring of City activity has included both internal and external groups from all levels of government.

3. To date, there have been two revisions to the original revenue and expenditure forecasts of October 20, 1975. These revisions were in part necessitated by changes in the economy and slippages in specific expenditure reduction programs. Based upon reviews by Arthur Andersen and Co., fiscal year 1976 revenue projections will fall short by approximately $110 million and expenditures will be above the budget by $100-150 million.
4. Various monitoring groups have raised issues concerning the overall three year Financial Plan. In a report to the Emergency Financial Control Board, Mr. Stephen Berger, Executive Director, recommended that the City prepare a program of an additional $150 million in alternative cuts during fiscal year 1977 and a phasing in of planned program cuts for fiscal year 1978 so that they will be in place by July 1, 1977. The Emergency Financial Control Board, based on these recommendations, adopted a resolution on June 23, 1976, calling for a standby program of $135 million in alternative cuts or revenue measures, and a phasing in during the latter half of fiscal year 1977 of planned expenditure reductions for fiscal year 1978.

The General Accounting Office in a report released June 28, 1976, expressed concerns over various aspects not included in the Financial Plan. Additionally, GAO questioned whether three years is a long enough period of time to achieve the goals of the City's Plan.

5. Under the terms of the Seasonal Financing Act, New York City plans on borrowing a total of $2.175 billion from the Federal Government during fiscal year 1977. On July 1, 1976, the Department of the Treasury extended the first of these loans — $500 million, basing its determination of "reasonable prospect of repayment" essentially on two factors:

(a) The Emergency Financial Control Board's June 23, 1976, resolution requiring an additional $135 million in standby cuts for fiscal year 1977; and

(b) The "agreement in principle" that all City labor contracts will be in conformance with the Board's wage policy resolution.
6. New York City's financial situation after the end of the Federal loan program in June 1978 is in doubt. The GAO believes that some problems which may impact on the City's ability to reenter the private credit market have not been addressed in the Financial Plan. Among these are:

(a) The short-term notes in moratorium. If MAC is not able to effect an exchange of these notes for long-term bonds, the notes will mature in November 1978. The recent downgrading of certain MAC bonds by Moody's Investors Service, Inc., had a deleterious effect on a $500 million exchange offer. There is no provision in the Financial Plan for accumulating funds to repay notes in moratorium.

(b) The Department of the Treasury has expressed concern for the City's post-1978 condition, and has requested a Financial Plan for FY 1979 of the Emergency Financial Control Board.

7. Some commentators have suggested that the best course of action for New York City is default and bankruptcy. They base this conclusion on the recently amended Chapter IX of the Bankruptcy Act, and believe that such a source would permit the City to restructure its debt over a longer period of time, and to reduce and discard some taxation policies which act as disincentives to businesses and middle-class taxpayers remaining in the City. At the same time, they believe the City would be able to administer its governmental responsibilities subject to a judge-approved long-term plan.

Opponents of bankruptcy, who include most of the officials involved with New York City's financial situation, describe this course as the worst thing that could happen. They cite the possibilities of a resulting State bankruptcy as well, the "ripple" or "domino" effect on other municipalities' bond.
ratings, the costs to the Federal Government through direct assistance for services which the City would be unable to provide and the impact on financial institutions holding New York paper. Opponents of bankruptcy also believe that there are State constitutional prohibitions to the diversion of debt-service money for City services, that the laws of other States would prohibit fiduciaries from investing in New York paper in the post-default period, and that a bankruptcy would accelerate the outmigration of businesses and the middle class. The debate over the advisability of bankruptcy is a conjectural one, and raises more questions than it answers. A city the size of New York has never before been faced with bankruptcy, and the amended Chapter IX has not been tested.

8. Many factors in New York City's financial crisis weigh heavy on that City's economic future. By law, New York City must balance its budget by June 30, 1978. To do this, over $1 billion must be removed from its budget. At the same time, the City must see that these expenditure reductions do not curtail essential services so as to eliminate the possibility of maintaining adequate service levels and a decent quality of life for New Yorkers.

New York City has been losing substantial segments of its commercial and industrial community. Manufacturing firms are leaving, wholesale and retail trade has slacked off, the real estate market has been shrinking, and as a consequence of the City's declining economy, there is an exacerbation of the unemployment rate.
The ratio of New York City's income to the rest of the nation has been on a continuous decline since 1965. One possible cause of this is the influx of rural and minority poor accompanied by the outmigration of middle- and upper-income families to the suburbs.

City leaders believe that new and different policies must be formulated at all levels -- Federal, State and local, in order to maintain and bolster the City's economic future. They believe that Federal policies have favored other regions of the country and that the tax burden in New York City has created a major disincentive for businesses to remain or return. Little relief appears to be in sight.
To the President of the Senate and the Speaker of the House of Representatives:

Pursuant to provisions of the New York City Seasonal Financing Act of 1975 (Public Law 94-143) we have been reviewing New York City's progress under its 3-year financial plan. This report is the first of a series which we will submit to the Congress.

The plan, drawn together during a period of crisis, was a first step toward fiscal recovery. In our opinion, however, it did not recognize some major problems facing the city both during and after the 3-year period. We believe that the inclusion of the following items in the plan would contribute to the city's chance of recovery:

- An arrangement for retiring the debt in moratorium.
- The additional operating deficit represented by the operating expenses included in the capital budget.
- Plans for contingencies such as a possible increase in city pension contributions and the anticipated deficit in the New York City Transit Authority's operations.

Federal short-term loans to the city are authorized only through June 30, 1978--the termination date of the city's financial plan. However, the magnitude of the above factors points to the need for a city plan covering a period longer than 3 years. A longer plan, if properly detailed, should provide a more realistic view of the city's financial picture. By recognizing its problems and planning for their resolution, the city should be able to improve its credibility, increase investor confidence, and enhance its chances to reenter the private credit market when the Federal loans terminate.

GGD-76-94
We believe that the Secretary of the Treasury should require that city and State officials revise the plan to make it as comprehensive and realistic as possible by recognizing factors such as those identified in this report. A summary of our observations is enclosed.

The contents of this report have been discussed with city, State, and Treasury officials, and their comments were considered in the preparation of the report.

We are sending copies of this report to the Secretary of the Treasury and the Director, Office of Management and Budget.

Comptroller General
of the United States

Enclosure
New York City's financial crisis became widely known when the city found itself no longer able to borrow money in the private credit market to meet its cash needs.

New York, like other cities, must borrow to fund expenses during periods of cash shortfalls which result from the mismatch in the timing of revenue collections and expenditures. When it was unable to do so in early 1975, New York City was faced with a crisis. New York's problem was complicated by the fact that it was borrowing not only for short-term cash needs but other purposes as well. Prior years' deficits had been funded with short-term borrowings and these had to be refinanced as they matured. In addition, the city had borrowed on short-term bond anticipation notes to pay for capital construction projects. These notes also had to be refinanced when they came due. Therefore, the city was borrowing to pay off previous loans as well as to meet current needs.

The cumulative effect of all this borrowing put New York City in the position of having $5.3 billion in short-term notes outstanding as of June 1, 1975. This represented about 29 percent of the national total of short-term municipal debt outstanding at that time. At the same time, municipal borrowings nationwide had reached an all-time high in early 1975. This, coupled with public charges of poor city management, undoubtedly contributed to a lack of demand for New York City's securities. In any case, a so-called crisis of confidence developed and investors stopped buying New York City's securities.

Initially, New York State advanced funds to the city to make up for its immediate cash shortfalls in April and May 1975. Subsequently, the State created the Municipal Assistance Corporation (MAC) to alleviate the problem by consolidating the city's short-term debt and issuing moral obligation bonds of the State. When these actions fell short of solving the problem,
the Legislature passed the New York State Financial Emergency Act in September 1975, which created an Emergency Financial Control Board to control and supervise the financial management of the city and to approve a 3-year plan to be developed by the city to provide for its recovery. The Control Board approved the plan in October 1975.

The plan had to be drawn in a crisis situation. The data available from the city was sketchy and questionable, and the threat that the city would be unable to meet its payrolls was ever present. In addition, about $2.6 billion in short-term notes were due to mature at about that same time. The spectre of default was real.

The Financial Emergency Act required that the city's budget be balanced for the fiscal year ending June 30, 1978. The approved plan conformed to that legislative requirement and provided for substantial budget cuts in fiscal years 1976, 1977, and 1978 to meet the goal. The Control Board set the overall goals for the budget cuts but left to the city the requirement to translate those overall amounts to specific program cuts.

The plan and the cuts dictated by the Control Board in October 1975 can be summarized as follows:

<table>
<thead>
<tr>
<th>Fiscal years ($ in millions)</th>
<th>1976 (partial)</th>
<th>1977</th>
<th>1978</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td>$ 8,392</td>
<td>$11,992</td>
<td>$12,294</td>
</tr>
<tr>
<td>Expenditures</td>
<td>(9,148)</td>
<td>(12,924)</td>
<td>(12,988)</td>
</tr>
<tr>
<td>Deficit</td>
<td>(756)</td>
<td>(932)</td>
<td>(694)</td>
</tr>
<tr>
<td>Planned cuts</td>
<td>92</td>
<td>462</td>
<td>724</td>
</tr>
<tr>
<td>Revised deficit</td>
<td>$(664)</td>
<td>$(470)</td>
<td>$(30)</td>
</tr>
</tbody>
</table>
As part of the plan, the Control Board assumed Federal assistance in the form of long-term loan guarantees, and city officials appealed to the Federal Government for help. In December 1975, the Congress passed the New York City Seasonal Financing Act of 1975 which provided only for short-term loans to make up for the city's seasonal cash shortfalls rather than the proposed long-term loan guarantees. Under the act, seasonal loans of up to $2.3 billion per year were to be made to the city for cash shortfalls occurring within a fiscal year and repaid to the Treasury at the end of each of the city's fiscal years.

In March 1976, the city submitted a proposed revision to the October 1975 plan which provided for additional budget cuts of $117 million in fiscal year 1977, and $221 million in fiscal year 1978, for a cumulative total of $1.062 billion, instead of the originally planned $724 million. At the time of our review these revisions had not yet been totally approved by the Control Board.

In summary, the objective of the State and Federal legislation is to assist the city in maintaining its services while it restructures and restructures financially between October 1975 and June 1978. Subsequent to that time, assuming all parts of the plan are successful, the city is supposed to be in a position to return to the private credit market to borrow funds in the normal course of business, and the Federal assistance is to cease.

PROBLEMS NOT ADEQUATELY RECOGNIZED IN THE PLAN

On April 2, 1976, we expressed concern before the Senate Committee on Banking, Housing, and Urban Affairs about the city's progress and adherence to the financial plan. We also stated that we were equally concerned whether such adherence would necessarily result in a balanced budget in future years and the restoration of investor confidence. We suggested that it may not be too early to consider the need for a more realistic and comprehensive plan.

The city has been operating under the plan for several months, and various observers have had opportunities to assess city compliance. Reports addressing this subject have been
issued by MAC, the Control Board, and the State of New York. Each of these reports concluded there is a strong possibility that planned budget cuts will not be sufficient to eliminate the deficit by June 30, 1978. Recommendations have been made for the city to plan and effect additional budget cuts.

On June 16, 1976, the Secretary of the Treasury, who administers the Federal seasonal loan program, requested the Control Board to begin addressing broader problems such as a plan for fiscal year 1979 and beyond, erosion of the tax base, and similar longer range concerns. We agree with the need for such plans. Moreover, we believe that the city should develop and incorporate into its current plan, policies and plans for resolving a number of problems which may immediately impact on its ability to reenter the private credit market when the Federal seasonal loan program terminates in June 1978. These problems include

--the large amount of debt in moratorium which is due after the plan's end,

--the matter of employee compensation in fiscal year 1979,

--the additional operating deficit represented by the operating expenses included in the capital budget,

--the need to plan for contingencies such as possible increased pension contributions, and the anticipated deficit in the city Transit Authority's operations.

Moratorium debt

Toward the end of 1975 about $2.6 billion in city short-term notes were outstanding. Most of the notes were scheduled to mature between December 1975 and March 1976. Because the city did not have the funds to redeem the notes, and because it was unable to borrow funds to refinance the notes, the city appealed to the State for assistance. The State Legislature on November 14, 1975, passed the New York State Emergency Moratorium Act for the city of New York which postponed the maturity of the notes until November 1978. The act required the city to offer its noteholders the option to convert their notes in moratorium to long-term MAC bonds.
The city notes had interest rates which ranged from 7.5 percent to 9.5 percent. If a noteholder chose to convert to MAC bonds he received interest at the rate of 8 percent, but if he chose not to convert he would receive only 6 percent during the moratorium.

Some noteholders protested the Legislature's action and are pursuing a remedy in the courts. Some, however, did convert, but after the expiration of the option period, about $1.961 billion in notes were still outstanding and subject to the moratorium.

The city had meanwhile entered into an agreement for an extended repayment period with five city pension funds and 11 New York clearing house banks which held a total of $819 million in notes. That agreement called for repayment on notes in installments of about $96 million per year between fiscal years 1979 and 1987. The holders of the remaining notes, which amount to about $1.1 billion, are due payment of the total amount in November 1978.

Although the city's original problem was solved by the moratorium, the solution may have created another problem almost as serious—the $1.1 billion of notes coming due in November 1978. MAC is currently offering long-term bonds in exchange for $500 million of the outstanding notes in moratorium. If MAC is successful, the city's problem will be somewhat alleviated. The financial plan makes no provision for accumulating the funds necessary to repay the notes; therefore, we believe the existence of the debt in moratorium should be recognized in the plan along with the city's proposed method for dealing with any amounts due in 1978. This would enable investors and the general public to be fully informed as to the city's planned course of action.

**Employee compensation**

The 3-year financial plan assumed there would be no wage increases for employees during the plan period and no cost of living adjustments beyond the one already granted for 1976. The Control Board modified this policy somewhat by providing that increases or adjustments could be given if their total costs were offset by measurable savings over and above those already provided for in the financial plan. The need for such a policy is clear, and adherence to it is crucial for successful completion of the plan.
The financial plan, and therefore the wage policy, applies only to the period ending June 30, 1978. The city is currently negotiating contracts with employee unions and the effect of agreements reached will have a direct impact on Treasury's decision to make the next seasonal loan. Likewise, the matter of wages may have a direct bearing on the city's ability to reenter the private credit market after the Federal loans terminate in June 1978. To bolster investor confidence in the stability of its fiscal future, the city should develop plans for wage policies sufficiently in advance of July 1, 1978, so that the fiscal impact of wage increases, if any, can be adequately provided for in the budget for fiscal year 1979.

**Understated operating expenses**

New York City pays for all normal costs of operations such as salaries, supplies and the like, out of its expense budget. Its capital budget funds the costs of major improvements and new construction.

For a number of years, the city has been following the practice of funding some operating expenses through its capital budget and issuing bonds or bond anticipation notes to raise funds to meet these expenses. When the plan was prepared, this amount approximated $700 million. This practice understates the true cost of operating and providing city services and it overstates the cost of the city's capital budget.

The State recognized this distortion and in 1975 passed legislation requiring that these costs be eliminated from the capital budget over a 10-year period. In order to correct this distortion immediately, the city would have had to either increase revenues or further reduce expenditures or some combination of the two by $700 million per year.

In accordance with the State legislation the 3-year plan provided for the reclassification of these expenses starting with $30 million in the first year. Until the reclassification is completed, however, both the operating and the capital budgets will not disclose their true levels.

In effect, the city is spending $700 million per year for items and services which it is not financing with current revenues. At the end of the 3-year financial plan period the budget will appear to be balanced, as a result of making the planned budget cuts of $1.062 billion, but the city will not have counted all of its expenses. The expense side of the 1978 budget will be understated by about $520 million of operating expenses which will not have been reclassified at that date.
We believe the city's financial plan should clearly indicate the additional operating deficit represented by these expenses and should include proposals for funding these expenses during and after the period covered by the plan.

**Contingent pension and transit costs**

At the time the plan was drawn together there was a question as to whether the city was contributing a sufficient amount to its employee pension funds. The Mayor had earlier requested his Management Advisory Board to look into this question but the Board had not reported back in time for its findings to be considered during the preparation of the 3-year financial plan.

In April 1976, the Management Advisory Board submitted its report and recommended that the city increase its contribution by $208 million per year. The Board suggested, however, that this contribution could be phased in over several years. The increased contributions would then be something less than the full amount, until 1981 when the city would begin to contribute the full $208 million.

We have not reviewed the pension study as yet, but we noted that there are suggestions in the report that most of the city's additional contributions could be offset by various factors such as increased employee contributions. While the actual impact of this matter on the city is unclear at this time, the extent to which additional contributions may be required should be recognized by the city in its plan.

A similar contingency exists in the transit area. In April 1976 the Control Board learned that the New York City Transit Authority expected deficits of $108.8 million in fiscal year 1977 and $102.3 million in fiscal year 1978. City officials pointed out that the city has no funds to increase its subsidy and that the deficits in question, therefore, will have to be made up by Federal or State subsidies, increased taxes, or transit fare increases. In any case, this will impact on the city's budget or its economy. This impact should be assessed and the city's proposed course of action should be incorporated in the plan.
To the extent that other contingencies such as these exist, the plan document should recognize them and specify what actions the city plans to take. We believe it is particularly important that potential investors and the general public be able to see that city management has recognized and realistically planned for the resolution of all major issues.

CONCLUSIONS

The viability of any plan depends in good part on the adequacy of the data used and the assumptions made in putting the plan together. To ignore some problems or minimize others can reduce the chances of success. To limit the period covered by the plan to the period of Federal seasonal loans can leave too many unanswered questions of a significant nature which will impact heavily on the city's future fiscal stability.

An underlying assumption is that the present plan, if properly executed, will result in a balanced budget for the fiscal year ending June 30, 1978, and enable the city to reenter the private credit market. In our opinion, the city is postponing some of its problems in lieu of addressing them directly with a realistic plan. By failing to address these problems and devise a course of action to resolve them, the city may be unable to restore investor confidence.

The city's plan, in our opinion, should be a blueprint for action by public officials and employees. Equally important, it should be a document which the people of the city and potential investors can use to assess the progress the city is making in solving its fiscal problems. We believe the plan should be drawn on a realistic basis and should include all the foreseeable factors which might impact on the city's future and identify for all concerned the steps which the city will take to correct all identified problems.

The factors discussed in this report are by no means all inclusive. The complicated workings of the New York City Government, combined with its lack of adequate accounting data and management information, make it impossible to assess with certainty all of the problems involved. We believe, however, the types of items discussed here are significant enough to warrant serious consideration as to the need for a revised plan at this point in time. The degree of investor
confidence will determine the ability of New York City to reenter the market and also the interest rates to be paid. Leaving major unanswered questions open to speculation will not, in our opinion, help the city.

RECOMMENDATION

The Secretary of the Treasury should require that city and State officials revise the plan and make it as comprehensive and realistic as possible by recognizing factors such as those identified in this report.
To the President of the Senate and the Speaker of the House of Representatives

Pursuant to provisions of the New York City Seasonal Financing Act of 1975 (Public Law 94-143), we have been reviewing New York City's progress under its 3-year financial plan. This report is the one of a series which we will submit to the Congress.

The enclosure contains our observations on the City's efforts to improve its accounting systems. We reviewed these efforts because improved accounting systems are essential to the internal management of the City and to the City's return to the credit markets.

The Credit Agreement under which seasonal loans are made to the City by the Federal Government requires, among other things, that the City establish an accounting system by July 1, 1977, which would enable an auditor to perform an annual audit and render an opinion thereon. The objective of our review was to determine the City's plans for improving its accounting systems; the status of the improvements as of August 31, 1976; and an evaluation of the problems which may preclude the City from making the accounting system improvements which the Credit Agreement requires by July 1, 1977.
We have concluded that, although the accomplishments of the City and its contractors have far exceeded those which would normally be expected in such a complex system development effort, various problems will preclude the City from implementing the new accounting system by July 1, 1977, and producing financial statements for the year ending June 30, 1978, which can receive an auditor's unqualified opinion. Although the Credit Agreement does not require the auditor's opinion to be unqualified, we believe that the city should do everything possible to achieve this because a qualified opinion, depending upon its significance as perceived by investors, could discourage investors and affect the city's return to the credit markets.

The problems which we believe will preclude the implementation of the new system are caused by the relatively short time remaining until July 1, 1977. We have concluded that it is highly unlikely that enough time remains to (1) complete required documentation, prepare computer software, and adequately test the new system; (2) acquire and train the personnel required to operate the automated aspects of the system; and (3) prepare training materials and train the estimated 7,500 City employees who will be associated with the new system.

Other problems which we believe will preclude the City from producing financial statements for the year ending June 30, 1978, which can receive an auditor's unqualified opinion are the
(1) inclusion of probable inaccurate payroll data in the statements, (2) lack of required financial statements for intragovernmental and certain enterprise funds, (3) inclusion of inaccurate data in the financial statements for the Capital Projects Fund, and (4) lack of a required statement of general fixed assets.

In our opinion, it would be a mistake to implement the system before it has been adequately documented and tested and before training has been completed. Therefore, we have recommended, in essence, that the City request authorization from Treasury Department and New York State officials to take the following actions:

--- Implement on July 1, 1977, only those aspects of the new system that have been completed, giving priority to those aspects of the system needed to exercise control over revenues and expenditures and to prepare auditable financial statements as of June 30, 1978.

--- Delay implementation of those aspects of the system for which training cannot be completed by July 1, 1977.

--- Limit the audit of the financial statements for the year ending June 30, 1978, to that financial information produced by the new budgeting and accounting system. Such an audit would give the City confirmation that the implemented aspects of the new system
were operating properly, but save the expense of auditing data that is known to be inaccurate. State and City auditors should continue to audit internal controls of all of the City's accounting systems to identify areas requiring corrective action.

---Excluding financial statements for the Capital Projects Fund and the statement of general fixed assets from the audit for the year ending June 30, 1978, but prepare accurate statements for the year ending June 30, 1979.

We recommend that the Treasury Department authorize the City to take the actions which we have recommended. In our opinion, such authorizations would permit the City to implement the new budgeting and accounting system in a more orderly and effective manner and also permit many duplicative efforts to be terminated.

The contents of this report have been discussed with City, New York State, and Treasury Department officials and their comments were considered in the preparation of the report.

We are sending copies of this report to the Secretary of the Treasury and the Director, Office of Management and Budget.

Comptroller General
of the United States

Enclosure

- 4 -
GAO OBSERVATIONS
ON NEW YORK CITY'S EFFORTS
TO IMPROVE ITS ACCOUNTING SYSTEMS

The Credit Agreement under which seasonal loans are made to New York City by the Federal Government requires, among other things, that the City and New York State Emergency Financial Control Board "pursue with diligence the design and implementation of a new accounting system and * * * that by July 1, 1977, the City will have established an accounting system which will establish records and controls which would enable an auditor to perform an annual audit and render an opinion thereon." The Credit Agreement also requires the City to improve the reliability of its existing financial records, and the reports generated therefrom, and to adopt a system of internal controls over the receipt and disbursement of City funds.

Our review was conducted under authority of the New York City Seasonal Financing Act of 1975 (Public Law 94-143). We reviewed the City's efforts to improve its accounting systems because the improvements are essential to the internal management of the City and to the City's return to the credit markets.

SCOPE OF REVIEW

Our review was conducted in New York City and consisted of a review of pertinent documents and interviews with City officials responsible for the accounting systems improvements and with various contractors engaged to improve the City's accounting systems. Our review was limited to a determination of the City's plans for
improving its accounting systems; the status of the improvements as of August 31, 1976; and an evaluation of problems which may preclude the City from making the accounting system improvements which the Credit Agreement requires by July 1, 1977.

**IMPROVEMENTS NEEDED IN EXISTING SYSTEM**

Numerous weaknesses have been identified in the City's accounting system since mid-1975 by various organizations responsible for oversight of the City's financial management. Although we are not aware of a comprehensive listing of the weaknesses, many of them were identified in a report dated December 29, 1975, to the Secretary of the Treasury from the certified public accounting firm of Arthur Andersen & Co., which was engaged by the Department of the Treasury to obtain certain financial and accounting information about the City. Some of the more serious weaknesses identified in the report are as follows:

--Lack of controls and inadequacies in the overall accounting systems and procedures.

--Lack of good accounting and systems discipline in the agencies and data processing centers, and the absence of a capable internal systems staff.

--Fund control structure not useful for control of revenues, expenditures, and fund balances.

--Cumbersome and uncontrolled program budgeting and accounting procedures.
--Recording expenditures on a cash basis and revenue on an accrual basis.
--Delay in agency processing of vouchers.
--Expenses for contracts not recognized until vouchers are processed.
--Inherent controls in municipal fund accounting weakened by allowing transfers of moneys between funds.
--Two funds for special and miscellaneous revenues not under the normal budgetary control system.
--Accounting and financial data processing systems that are inadequately integrated, redundant, inconsistent, and unreconciled.
--Bank balances not reconciled for several years.
--Information on cash balances maintained by the Comptroller and the Director of Finance differing by several million dollars.
--Inadequate controls over data entering the disbursement processing system, rejected vouchers, and the timing of disbursement requests.

CITY'S PLAN FOR IMPROVING ACCOUNTING

Weaknesses in the City's accounting system were recognized when the New York State Legislature created the Municipal Assistance Corporation (MAC) in June 1975 to provide the City with a temporary source of credit until investor confidence could be
restored. The act required the City to adopt improved accounting methods and employ them in producing audited financial statements for the fiscal year ending June 30, 1978, and thereafter.

The City elected to get contractual assistance to enable it to define new budgeting and accounting principles, develop new public and management financial reports, and develop a systems concept for new budgeting and accounting systems. Two contracts were awarded on December 5, 1975: one to Touche Ross & Co. and the other to American Management Systems, Inc.

The two contractors collaborated and on January 15, 1976, produced a 15-volume report, "City of New York Policies, Procedures, and Systems," to provide the framework for the design and implementation of a new financial management process for the City. The plan called for the design of four subsystems:

--Budget. This subsystem is to provide separate revenue and expense budgets and establish monthly revenue recognition, cash collection, and spending plans. The revenue budget will identify each separate fund source and responsible organization. The expense budget will be by organizational unit.

--Encumbrance control. This subsystem is to provide central accounting for commitments (requisitions), encumbrances (purchase orders), and expenses (vouchers). It will
permit the availability of funds to be determined by the computer before an encumbrance is incurred.

---Accounting and financial reporting. This subsystem is to be the basic management tool for monitoring the City's financial position. The subsystem will include the following accounting operations:

- Cash disbursements
- Cash collections
- Processing of accounting data
- General ledger maintenance
- Financial reporting

The subsystem will provide monthly reports comparing revenue, cash collections, and spending against plans provided by the budget subsystem.

---Payroll/personnel. This subsystem is to be an integrated system which will perform all of the basic functions of a payroll system as well as maintaining the personnel master file.

In February 1976 the City awarded contracts to American Management Systems, Inc., Touche Ross & Co., Ernst & Ernst, and the Research Foundation of the City University of New York on behalf of the Urban Academy (the organization responsible for developing training programs for the City).

The contracts with American Management Systems, Inc., Touche Ross & Co., and Ernst & Ernst required each of them to
assist the City in establishing financial management policies, defining reporting requirements, and strengthening organization structures and personnel skills as required. In addition to these general requirements, each contractor was given specific assignments. American Management Systems, Inc., was to prepare a general design for the four subsystems and provide automatic data processing support. Touche Ross & Co. was to assist in (1) the design of the four subsystems, (2) development of the overall implementation plan, and (3) coordination of the project and maintenance of the overall project schedule. Touche Ross & Co. was also to prepare procedures for improving control over Federal and State aid revenues and certain types of encumbrances. Ernst & Ernst was to develop an implementation plan for installing the new subsystems and to prepare the documentation needed to convert the City's departments to the new system.

The contract with the Research Foundation of the City University of New York required the Urban Academy, with the cooperation of the other contractors, to identify the groups of employees to be trained, develop training requirements and, subsequently, to prepare training manuals and conduct training classes.

Although the new accounting system was not expected to be implemented until July 1, 1977, the four contracts were limited
to that work to be performed to September 15, 1976. The City awarded new contracts to all four contractors in August 1976 to permit the work to continue without interruption.

In May 1976 the City engaged an additional contractor to assist in the accounting system improvement effort. A contract was awarded to Bradford National Corporation for assistance in preparing the automatic data processing aspects of the new system and for the design of the payroll/personnel subsystem.

STATUS OF THE PROJECT AT AUGUST 31, 1976

The City and its contractors have made remarkable progress toward the implementation of a new accounting system by July 1, 1977, the date mandated by the State of New York and the Treasury Department. In the 9 months since the first contracts were awarded, the accomplishments of the City and its contractors far exceed those which would normally be expected in such a complex system development effort.

American Management Systems, Inc., literature indicates that development of a complex system, as this one is, requires 31 to 88 months, depending upon whether certain phases are performed sequentially or concurrently. We believe that these estimates are reasonably accurate. If the City's new system is implemented on July 1, 1977, as mandated, only 18 months will have elapsed since the first contracts were awarded in December 1975. It may be that the July 1, 1977, date was established
without contemplating the magnitude of the systems design effort subsequently set forth in the January 15, 1976, report to the City by the contractors.

In addition to the work on the new system, the City and its contractors have improved some existing systems and are in the process of improving others. This work was also mandated by the State of New York and the Treasury Department.

The status of the various aspects of the budgeting and accounting improvement project at August 31, 1976, is as follows:

--New system. Except for the payroll/personnel subsystem, the general design documentation has been completed and is being reviewed by Touche Ross & Co. and Ernst and Ernst for the purpose of identifying omissions and errors. American Management Systems, Inc., and Bradford National Corporation are preparing computer programs. Ernst and Ernst has determined the requirements for implementing the subsystems in the agencies and is preparing implementation plans. The Urban Academy has identified the groups of employees to be trained, reviewed the design documentation to identify training requirements, and started preparing training manuals.

--New payroll/personnel subsystem. The design of this subsystem was recently started by Bradford National Corporation. The City plans to implement part of the subsystem
on July 1, 1977, and complete its implementation on January 1, 1978.

--City Comptroller's system. Touche Ross & Co. is improving the City Comptroller's present accounting system. The City plans to use the system to do the accounting for the Capital Projects Fund beginning January 1, 1977.

--Payroll system. American Management Systems, Inc., is improving the present payroll system. The City plans to continue to use the system until the new payroll/personnel subsystem is implemented, presently scheduled for January 1, 1978.

--Interim encumbrance system. Touche Ross & Co. designed this system, which improves control over certain types of encumbrances, and helped the City to implement it in six agencies on July 1, 1976. While implemented, a recent study for the Secretary of the Treasury by Arthur Andersen & Co. indicated that reports generated by the system were satisfactory in one agency but not in another.

--Interim Federal and State aid revenue system. Touche Ross & Co. designed this system, which improves control over revenues from grants, and is helping the City implement the system in four agencies. The Arthur Andersen & Co. survey for Treasury also included the implementation of this program at two agencies. The survey found problems with the level of detail and the timeliness of the reports.
PROBLEMS MAY PRECLUDE COMPLIANCE
WITH CREDIT AGREEMENT

Although the efforts of the City and its contractors to improve the City's budgeting and accounting systems are commendable, it is apparent that various problems will preclude the City from (1) implementing the new accounting system by July 1, 1977, as required by the Credit Agreement, and (2) producing financial statements for the year ending June 30, 1978, which can receive an auditor's unqualified opinion.

In regard to the auditor's opinion, the Credit Agreement only requires the City to establish an accounting system which "would enable an auditor to perform an annual audit and render an opinion thereon." We believe that the City should do everything possible to produce financial statements which can receive an unqualified opinion, because a qualified opinion, depending on its significance as perceived by investors, could discourage investors and delay the City's return to the credit markets.

Many of these problems require action by the City. We have recommended these actions to City officials under authority of the Credit Agreement, which requires the City to give careful consideration to recommendations which we make with respect to interim improvements in the City's accounting systems. The problems are discussed in the following sections.
Some aspects of new system may not be completed by July 1, 1977.

We believe that, because of the amount of work to be completed and the short time remaining, it is highly improbable that the entire system can be installed and operating properly on July 1, 1977.

The design and implementation of a complex automated system, such as the one being developed for the City, requires a long period of time because requirements must be determined, a large volume of documentation must be prepared, and numerous computer programs must be written and tested. On the City's project, time had to be allowed to permit the documentation to be reviewed by each of the numerous concerned parties—several State and City officials and representatives of each contractor—and to implement their suggested changes.

As stated previously, whereas it usually requires between 31 and 88 months to design and implement a complex automated system, the State of New York mandated in June 1975 that a new system be installed by July 1, 1977, only 24 months later. Only 18 months remained available to develop the system when the City awarded the first contracts in December 1975.

Through various means, the City and its contractors have successfully minimized slippages in the project. It is increasingly apparent, however, that the entire system may not be ready for implementation on July 1, 1977, as planned. Some of
the conditions, based upon our experience with other complex
system design efforts, which could cause slippage in the project
are as follows.

--Computer software. The computer software for the new
budgeting and accounting system is very complex. It con-
sists of an immensely complicated data base management
system, obtained from International Business Machines
Corporation, several other commercial software packages,
and several hundred tailored programs. Among other things,
the tailored programs, to be prepared by American Manage-
ment Systems, Inc., and Bradford National Corporation,
must tie the data base management system and the commer-
cial software packages into a workable unit.

City and contractor officials informed us that they expect
to complete the tailored programs on schedule, but that
slippage in the project will occur if one of the commercial
software packages does not operate properly or if mistakes
are made in the tailored programs.

--Testing. To insure that the automated aspects of a new
system will operate properly when they are installed, it
is customary to perform various tests as the computer
programs are prepared and after they have all been com-
pleted. The new system will be subjected to essentially
all of the customary tests but, because of the limited
- 12 -
amount of time available to develop the system, the tests will include fewer transactions than usual. In addition, much of the testing which will be conducted will be performed on a contractor's computer complex because the City's computer complex is not installed. Computer complexes are rarely identically configured and therefore testing will also be required on the City's computer.

In addition to these general design problem areas, we have observed specific problems with the design documentation for the New York City systems. At August 31, 1976, several actions were pending which could require substantial revisions in the design documentation, and possibly in some computer programs. Touche Ross & Co. and Ernst and Ernst were reviewing the design documentation for the purpose of identifying errors and omissions. The Urban Academy was reviewing the design documentation to identify additional information needed to prepare training materials. MAC officials were considering the City's request to defer the establishment of enterprise and intragovernmental funds and the development of an inventory of existing fixed assets. In addition, State officials had already decided to require the City to revise the account structure which will require modification in the documentation for the new system.
City and contractor officials agreed with our conclusion that it was highly unlikely that the entire new system could be implemented on July 1, 1977. One City official believed, however, that a contingency plan should not be prepared until February or March 1977 because he expects it might discourage personnel working on the project.

Recommendations

1. City officials should immediately prepare a plan for initially implementing those aspects of the design that must be completed and in operation on July 1, 1977, giving priority to those aspects of the system needed to exercise control over revenues and expenditures and to prepare auditable financial statements as of June 30, 1978. The City should request and New York State and Treasury Department officials should grant authorization to carry out the plan.

2. For those aspects of the system that are not implemented as of July 1, 1977, City officials should prepare to capture and store transactions for processing when the system is capable of handling them.

Readiness of Financial Information Services Agency questionable

We believe that the Financial Information Services Agency, which is to perform the automatic data processing operations for the new budgeting and accounting system, will not be operational on July 1, 1977, if certain actions are not promptly taken.
By Executive Order dated September 15, 1976, the Mayor created an agency to perform the automatic data processing operations for the new system because the City's existing automatic data processing facilities were inadequate. To begin operations on July 1, 1977, City officials determined that all agency personnel must be acquired and trained by May 1977.

To have a complete and trained staff by May 1, 1977, the City must accomplish the following:

--- Have the establishment of the agency confirmed by the City Council. Although City officials intend to begin staffing the agency before the Council's approval is obtained, establishment of the agency will be delayed if the Council disapproves the City's action.

--- Prepare position descriptions. The City Personnel Department is preparing position descriptions for the 75 positions needed to staff the agency. We were informed that the preparation of the descriptions is expected to take several weeks because Personnel Department officials and project officials do not agree on how the positions should be classified and described.

--- Acquire personnel. City officials have determined that the Director of the agency should be permitted to acquire the agency staff. The Director has not been selected and, therefore, no personnel have been hired or transferred to the agency from other agencies. City and contractor
officials agreed with our observation that the acquisition of qualified personnel for the agency may be time-consuming because of the relatively scarce skills required and the City's hiring procedures.

---Train personnel. Unless the City acquires highly trained and experienced personnel, extensive training of agency personnel will be required. We believe that it is unlikely that sufficient personnel can be acquired on short notice who will not require extensive training because of the relative scarcity of highly skilled data base management personnel.

We believe that it is apparent from the foregoing that immediate action is required by the City if the Financial Information Services Agency is to be operational by May 1977.

City officials informed us that they have selected a director for the agency, whom they expect to hire on or about October 1, 1976. They are hopeful that the appointment of a director will help to alleviate the other problems.

Recommendations

1. City officials should immediately request the City Council to confirm the establishment of the Financial Information Services Agency.

2. If Personnel Department and project officials are unable to agree upon position descriptions for employees of the agency, the Mayor should promptly take action to resolve the differences.
3. City officials should officially select a director for the agency at the earliest possible date.

4. City officials should develop an alternative means of performing the automatic data processing aspects of the new budgeting and accounting system in the event the agency is not operational on July 1, 1977. The most logical alternative would be for the City to contract for the needed services. If this alternative is selected, we recommend that the City solicit proposals at this time so that the contract can be awarded as soon as it is determined that a contractor's services will be required.

*Training of personnel may not be completed by July 1, 1977*

We believe that the City may have to defer implementation of some aspects of the new system unless actions are taken immediately to provide the Urban Academy with the additional information needed to prepare training materials and conduct the training.

The training task is a monumental one since it must address not only the accounting and computer personnel who will be directly concerned with running the system, but also all of the personnel connected with financial management who will impact on the input of information to the system. City officials have estimated that about 7,500 personnel will require training before the new system is implemented. The amount of training required will vary according to an employee's duties. It will be relatively minor for some and extensive for others.
A minimal amount of time remains available to prepare training materials and conduct the training. With some exceptions, the Urban Academy was unable to start preparing training materials and developing training courses until the system design documentation was completed in July 1976. Academy officials then reviewed the documentation to identify areas in which the information was insufficient for their purposes. We were informed that, although the documentation was generally excellent, about 100 such areas were identified.

We believe that it is highly probable that some training will not be completed before July 1, 1977, because the Urban Academy cannot complete its training materials until it receives additional information. It is doubtful that this information, which is listed below, will be available in the near future.

--Omissions identified in the system design documentation by the Urban Academy.

--Changes in the design which will result from the reviews of the design documentation being conducted by Touche Ross & Co. and Ernst and Ernst.

--Changes in the account structure required by State officials.

--Changes which may be required in the design if MAC officials do not grant the City's request to defer the establishment of enterprise and intragovernmental funds.
City and Urban Academy officials informed us that the training could be completed by July 1, 1977, only if the additional information is provided to the Academy within a few weeks. They also agreed that the system should not be implemented until training is completed.

Recommendations

1. City officials should promptly request and New York State and Treasury Department officials should grant authorization to defer implementation of those aspects of the system for which training cannot be completed by July 1, 1977.

2. MAC officials should promptly act upon the City's request to defer the implementation of enterprise and intragovernmental funds.

3. City and contractor officials should give high priority to the preparation of documentation needed by the Urban Academy.

Accurate payroll information may not be produced until December 1977

The City's decision to delay implementation of the new payroll/personnel subsystem may result in the inclusion of inaccurate data in the financial statements for the year ending June 30, 1978.

A new payroll/personnel subsystem was included in the new budgeting and accounting system planned for the City because of extensive weaknesses in the old payroll system. It was recognized by City and contractor officials that complete and accurate payroll information was essential to improve the financial
management of the City and to produce accurate financial statements. The original plan called for the implementation of a new payroll/personnel subsystem on July 1, 1977.

As a result of the short period of time available to design and implement the new system, City officials decided to implement only part of the new payroll/personnel subsystem on July 1, 1977, and to implement the remainder of the subsystem on January 1, 1978. As a result of this decision, the City will have to continue to use information produced by the old payroll system until January 1, 1978. At the City's request, American Management Systems, Inc., is making some changes in the old system to improve the accuracy of the information to be produced after July 1, 1977.

Audit personnel of the State Comptroller's office informed us that they did not believe that the improvements to the old system planned by the City would enable the system to produce complete and accurate information. As an example, they believed that the system would not preclude the issuance of payroll checks to personnel who had retired or been terminated, resulting in invalid payments and unrecorded refunds receivable. If this is the case, the City's financial statements for the year ending June 30, 1978, will probably be inaccurate because the new payroll/personnel subsystem will be in operation only half of the year.

City officials have not officially requested approval to defer implementation of the payroll/personnel subsystem from the
State or the Treasury Department. In view of the opinion of State audit personnel that the old payroll system will not be adequately improved, the City's request may not be favorably received. It is extremely doubtful, however, that the new payroll/personnel subsystem could be completely implemented by July 1, 1977, even if the State or the Treasury Department refused the City's request to defer its implementation. Because of this New York State and Treasury officials may have to accept a situation in which accurate payroll information may not be produced until December 1977 and the financial statements produced by the City for the year ending June 30, 1978, may be inaccurate.

The foregoing indicates that accurate payroll information will not be produced until December 1977 and, therefore, the financial statements produced by the City for the year ending June 30, 1978, will be inaccurate.

Recommendations

1. City officials should request and New York State and Treasury Department officials should grant authorization to defer implementation of the new payroll/personnel subsystem until December 1977.

2. City officials should request and New York State and Treasury Department officials should grant authorization to limit the audit of the financial statements for the year ending June 30, 1978, to that financial information produced by
the new budgeting and accounting system. Such an audit would
give the City confirmation that the implemented aspects of
the new system were operating properly, but save the expense
of auditing data that is known to be inaccurate. State and
City auditors should, of course, continue to audit internal
controls of all of the City's accounting systems with a view
to identifying areas requiring corrective action.

Intragovernmental and certain enter-
prise funds have not been established

The City has not established intragovernmental and certain
enterprise funds even though such funds are necessary to receive
an auditor's unqualified opinion on the City's financial
statements.

The principles of governmental accounting and reporting pro-
mulgated by the National Council on Governmental Accounting
require (1) enterprise funds to be established to account for the
financing of services to the general public where all or most of
the costs involved are paid in the form of charges to users of such
services and (2) intragovernmental service funds to be established
to account for the financing of special activities and services
performed by a designated organization unit within a governmental
jurisdiction for other organization units within the same govern-
mental jurisdiction. An auditor ordinarily will not give an
unqualified opinion on the financial statements of a municipal-
ity which has not complied with this principle.
We are aware of at least three City operations which should be accounted for as enterprise funds: Mitchell Lama housing, water and sewer, and off-street parking. City officials plan to account for the housing program as a separate fund starting July 1, 1977, but will defer accounting for water and sewer operations as a separate fund for 2 or 3 years. We were informed that the City has no plans to establish a separate fund for off-street parking operations because a relatively small amount of money is involved.

The City has numerous operations which should be operated as intragovernmental service funds. At the request of the City, Touche Ross & Co. performed a study of the services performed by the Municipal Services Administration and recommended that the following be accounted for as intragovernmental service funds: gas and electricity, purchasing, building maintenance and repair shops, municipal telephone service, motor pool, leased space, and data processing. However, City officials decided to defer establishing intragovernmental service funds until July 1979.

The design for the new budgeting and accounting system had already been completed without separate accounting for these funds when the City recently requested MAC to approve its decision to defer establishment of a water and sewer fund and all intragovernmental service funds. The City has not requested the Treasury Department to approve its decision even though such a request
appears to be warranted. In this regard, the Credit Agreement requires the City to establish an accounting system which would be in accordance with the accounting principles contained in the State Comptroller's Uniform System of Accounts for Municipalities, as modified by the State Comptroller in consultation with the City. These principles require the establishment of enterprise and intragovernmental service funds and, therefore, the City's failure to provide them would apparently constitute a violation of the terms of the Credit Agreement.

City officials informed us that they were unable to provide for the water and sewer fund and intragovernmental service funds in the design of the new budgeting and accounting system because of the limited time available to develop the system. They said that they did not believe that the deferral would result in a qualification of the financial statements because the amounts involved were relatively immaterial. They also said that they could construct financial statements for the water and sewer operation if statements were deemed necessary.

We believe that failure to establish the separate funds will result in qualification of the auditor's opinion. It should be noted that revenues for the water and sewer operation amount to about $200 million annually and services provided to other agencies by the Municipal Services Administration amount to about $189 million annually. We also believe that financial statements
constructed for these operations would probably not receive an unqualified opinion from an auditor because much of the information would be produced by cost systems within the present accounting systems operated by the agencies. Arthur Andersen & Co. in its December 29, 1975, report to the Secretary of the Treasury commented on "* * * the lack of good accounting and systems disciplines inherent in the agencies and data processing centers."

**Recommendations**

1. City officials should request and New York State and Treasury Department officials should grant authorization to defer the implementation of enterprise and intragovernmental service funds until July 1, 1978, in recognition of the City's inability to establish such funds by July 1, 1977.

2. City officials should promptly start those revisions in the budgeting and accounting system necessary to account for all enterprise and intragovernmental funds on July 1, 1978.

**Financial statements for the Capital Projects Fund will be Inaccurate**

The financial statements for the Capital Projects Fund for the year ending June 30, 1978, will undoubtedly be inaccurate because City officials decided not to correct data accumulated, or to be accumulated, prior to July 1, 1977.

The principles of governmental accounting and reporting promulgated by the National Council on Governmental Accounting require
financial statements for Capital Projects Funds to contain cumulative financial information about each project.

Most capital projects require several years to complete and, therefore, much of the financial information contained in the financial statements will have been accumulated in prior years.

City officials deferred inclusion of the Capital Projects Fund in the new budgeting and accounting system for 2 or 3 years because of the limited time available to design the system. They recognized that the existing accounting system was not producing complete and accurate data for the Capital Projects Fund, however, and requested Touche Ross & Co. to improve the accounting system presently operated by the Comptroller's office to permit it to produce reliable accounting information for the Capital Projects Fund.

City and contractor officials informed us that the Comptroller's accounting system was basically a good system and that they believed that it will produce complete and accurate information starting July 1, 1977. They stated, however, that they would not correct the financial information accumulated prior to July 1, 1977, because it would be time-consuming and expensive.

Through the years, the City has charged millions of dollars of expenses to the Capital Projects Fund which should have been charged to the General Fund. The City and the Municipal Assistance Corporation have agreed to a plan whereby the City will
stop charging such expenses to the Capital Projects Fund over a period of years. Although the City will give these expenses improved accounting visibility after July 1, 1977, the financial statements for the Capital Projects Fund will continue to be distorted by the expenses erroneously charged in prior years.

Recommendation

1. City officials should request and New York State and Treasury Department officials should grant authorization to exclude the Capital Projects Fund from an audit of the City's financial statements for 2 years, during which time the City should improve the accuracy of financial data produced prior to July 1, 1977.

Financial statements will not contain a statement of general fixed assets.

City officials do not plan to conduct a physical inventory of the City's buildings, which is necessary to achieve physical and monetary control and to receive an auditor's unqualified opinion on the City's financial statements.

In its industry audit guide for audits of State and local governmental units, the American Institute of Certified Public Accountants stated that a statement showing general fixed asset balances at the statement date is necessary for presentation of financial position. Although the inclusion of fixed assets other than buildings in the statement is optional, a certified public accountant is not to give an unqualified opinion on the financial
statements of a municipality which do not include a statement disclosing the value of the municipality's buildings.

The City has not maintained accurate records of its buildings and therefore will not have the information required to prepare a statement of general fixed asset balances at June 30, 1978, unless it conducts a physical inventory of all of the City's buildings and establishes their value. A City official informed us that they do not plan to make such an inventory because it would require an exorbitant amount of personnel resources. The City requested MAC to approve its decision not to conduct an inventory but, as of August 31, 1976, MAC had not acted upon the request.

In view of the many problems facing the City it may not be advisable for the City to perform that work necessary to include fixed assets in its June 30, 1978, financial statements. We believe, however, that it would be beneficial for the City to perform this work by June 30, 1979. In addition to avoiding a qualification of the auditor's opinion on the financial statements, it will provide potential investors with more complete information on the City's assets.

Recommendation

1. We recommend that the City defer inventorying and establishing the value of its buildings until after June 30, 1978, but prior to June 30, 1979.
MEMORANDUM

TO:        Hon. Abraham D. Beame
            Mayor

FROM:      Kenneth S. Axelsson

RE:        Treasury Loan

DATE:      June 18, 1976

Mark Coler, Assistant to Assistant Secretary of the Treasury Gerard, telephoned me at 2:30 p.m. today.

He stated that he had been instructed by Mr. Gerard to formally notify the City that settlement of the labor contracts with an "agreement in principle" was a necessary condition to renewal of the Treasury loan.

cc: S. Berger
    H. Elish
    S. Frigand
    D. Kummerfeld
    J. Zuccotti
MEMORANDUM

To Richard Albrecht, Esq.
General Counsel
United States Department of Treasury

From Allen L. Thomas

Subject Municipal Assistance Corporation
For The City of New York

Under the proposed Credit Agreement among the
United States of America, The City of New York (the "City") and
various other parties, a proof of which dated December 19, 1975,
has heretofore been delivered to us, it is proposed that the
Municipal Assistance Corporation For The City of New York (the
"Corporation") be included as a party as a potential "Borrower".

Under the Federal Act entitled "New York City Seasonal
Financing Act of 1975", (Public Law 94-143) federal loans may
be made to a "financing agent" other than the City if "the
City and such agent shall be jointly and severally liable thereon."
(See §4(a) of the New York City Seasonal Financing Act of 1975).

Accordingly, if the Corporation were to be a Borrower
under the Credit Agreement, the City would have to be jointly and
severally liable with respect to such borrowing in order to
meet the requirements of the New York City Seasonal Financing
Act of 1975.
It is hereby respectfully submitted that it is inappropriate under the New York State Constitution and the statutes governing the Corporation and its power to borrow, for the Corporation to be a Borrower under the Credit Agreement. Accordingly, it is respectfully requested that the Corporation be eliminated as a participant in the Credit Agreement.

Discussion

1. New York State Constitution

Art. VIII §1 of The New York State Constitution provides that "No ... city ... shall give or loan its credit to or in aid of any ... public or private corporation or association..."

There is no question that the Municipal Assistance Corporation For The City of New York is a "public corporation" within the meaning of the constitutional provision. Public Authorities Law §3033.

Similarly, there is little question that this provision would ordinarily bar a city within the State from undertaking "joint and several" liability for the repayment of a loan made directly to such corporation. Not only is this the apparent intent of the prohibition, but is is also the only inference to be drawn from subsequent language limiting the
sweep of Section 1. Thus, the Constitution goes on to provide, Section 1 notwithstanding, that:

"two or more such units [i.e., cities] may join together pursuant to law in providing any municipal facility, service, activity or undertaking which each of such units has the power to provide separately. Each such unit may be authorized by the legislature to contract joint or several indebtedness [and] pledge its or their faith and credit for the payment of such indebtedness for such joint undertaking ..."

There is no corresponding Constitutional exception which would sanction a joint undertaking between a city and a public corporation.

Moreover, the history of Art. VIII ¶1, and that of substantively identical provisions in other state constitutions, make clear that the provision was primarily intended to preclude political units of the State from assuming liability for the repayment of indebtedness contracted by public or private corporations. For example, in applying an Iowa constitutional provision copied almost verbatim from the New York State Constitution, the Iowa Supreme Court said:

"What is meant herein by a loan of 'credit'?

*** This particular section of our Constitution was taken bodily from the Constitution of New York. ... it withheld from the constituted authorities of the state all power or function of suretyship." Grout v. Kendall, 192 N.W. 529, 531 (Iowa 1923) (emphasis added)

The instant case, while not squarely within the mold of any apparent precedent, clearly invites an attack under Art. VIII.
It may be argued that a pledge by the City in this instance is not within the Constitutional prohibition because its dominant purpose would be to "aid" the City itself and not to "aid" the Corporation. In the case of Wein v. The State of New York, in which plaintiff argues that the State's issuance of revenue anticipation notes to fund an advance to the City violates a cognate ban on gifts or loans of the State's credit, we have argued, in the alternative, that the Constitution is not violated because the appropriations there involved were made primarily "in aid of" State objectives. That argument was approved by the New York State Supreme Court in its opinion upholding the procedure, Wein v. State of New York, Index No. 42394/75 (Sup. Ct. N.Y. Co. October 15, 1975) (Helman, J.), but has yet to receive the endorsement of the Court of Appeals, where an appeal is now pending.

The conclusion to be drawn is that, while a joint undertaking may be upheld, the transaction raises serious Constitutional questions which will inevitably produce additional litigation and perpetuate the uncertainty already clouding New York's financial future. Furthermore, such uncertainty would appear to be inconsistent with the intent of the New York City Seasonal Financing Act of 1975 and the Secretary's obligations thereunder.
2. Statutes Governing The Corporation

Section 3016 of the New York City Municipal Assistance Corporation Act provides as follows:

"State or state-aided municipality not liable on notes and bonds. The notes, bonds or other obligations of a municipal assistance corporation shall not be a debt of either the state or the municipality being assisted, and neither the state nor such municipality shall be liable thereon, nor shall they be payable out of any funds other than those of such corporation; and such notes and bonds shall contain on the face thereof a statement to such effect."

Accordingly, the Corporation does not appear to have the legal power and authority to issue notes, bonds or other obligations which notes, bonds or other obligations would constitute a debt of the City or upon which the City would be liable.

Furthermore, even if the Corporation were able to borrow from the United States pursuant to the Credit Agreement, the Corporation does not have any unencumbered source of revenue with which to repay such a loan.

The Corporation has two sources of revenue. The first source is the sales and stock transfer tax revenues dedicated to the Corporation in the original June 1975 legislation relating to the Corporation. This revenue source is pledged pursuant to the Corporation's First General Bond Resolution dated July 2, 1975 for the payment of the Corporation's outstanding bonds and notes. Under such First General Bond
Resolution, only a modest amount of bonds may now be issued pursuant to the coverage requirements of such Resolution and no short-term bonds or notes can now be issued under such Resolution in compliance with the coverage requirements.

The second revenue source is the per capita state aid dedicated to the Corporation pursuant to the emergency legislation passed in September 1975. Pursuant to the Corporation's Second General Bond Resolution, dated November 25, 1975, all revenue deriving from per capita state aid, and all sales and stock transfer revenues not used for debt service, capital reserve fund or operating requirements under the First General Bond Resolution (and not used for repayment of outstanding notes of the Corporation) are dedicated on a pari passu basis to the payment of bonds of the Corporation issued pursuant to the Second General Bond Resolution. The Corporation will be issuing bonds pursuant to the Second General Bond Resolution as a result of its outstanding Exchange Offer pursuant to its Official Statement dated November 26, 1975.

Accordingly, the Corporation has no unencumbered revenue source to support repayments of loans from the United States, even if the Corporation were constitutionally able to borrow under the New York City Seasonal Financing Act of 1975.
NEW YORK CITY SEASONAL FINANCING.
ACT OF 1975

For Legislative History of Act, see p. 3253

An Act to authorize the Secretary of the Treasury to provide seasonal financing for the city of New York.

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

SHORT TITLE

Section 1. This Act may be cited as the "New York City Seasonal Financing Act of 1975".

FINDINGS AND DECLARATIONS

Sec. 2. The Congress makes the following findings and declarations:

(1) It is necessary for the city of New York to obtain seasonal financing from time to time because the city's revenues and expenditures, even when in balance on an annual basis, are not received and disbursed at equivalent rates throughout the year.

(2) At the present time the city is or may be unable to obtain such seasonal financing from its customary sources.

(3) It is necessary to assure such seasonal financing, in order that the city of New York may maintain essential governmental services.

DEFINITIONS

Sec. 3. As used in this Act:

(a) "City" and "State" mean the city and State of New York, respectively.

(b) "Financing agent" means any agency duly authorized by State law to act on behalf or in the interest of the city with respect to the city's financial affairs.

(c) "Secretary" means the Secretary of the Treasury.

LOANS

Sec. 4. (a) Upon written request of the city or a financing agent, the Secretary may make loans to the city or such financing agent subject to the provisions of this Act, but in the case of any loan to a financing agent, the city and such agent shall be jointly and severally liable therefor.

(b) Each such loan shall mature not later than the last day of the city's fiscal year in which it was made, and shall bear interest at an annual rate 1 per centum per annum greater than the current average market yield on outstanding marketable obligations of the United States with remaining periods to maturity comparable to the maturities of such loan, as determined by the Secretary at the time of the loan.

SECURITY FOR LOANS

Sec. 5. In connection with any loan under this Act, the Secretary may require the city and any financing agent and, where he deems necessary, the State, to provide such security as he deems appropriate.
The Secretary may take such steps as he deems necessary to realize upon any collateral in which the United States has a security interest pursuant to this section to enforce any claim the United States may have against the city or any financing agent pursuant to this Act. Notwithstanding any other provision of law, Acts making appropriations may provide for the withholding of any payments from the United States to the city, either directly or through the State, which may be or may become due pursuant to any law and offset the amount of such withheld payments against any claim the Secretary may have against the city or any financing agent pursuant to this Act. With respect to debts incurred pursuant to this Act, for the purposes of section 3106 of the Revised Statutes (31 U.S.C. 191) the term "person" includes the city or any financing agent.

LIMITATIONS AND CRITERIA

31 USC 1505.

Sec. 6. (a) A loan may be made under this Act only if the Secretary determines that there is a reasonable prospect of repayment of the loan in accordance with its terms and conditions. In making the loan, the Secretary may require such terms and conditions as he may deem appropriate to assure repayment. The Secretary is authorized to agree to any modification, amendment, or waiver of any such term or condition as he deems desirable to protect the interests of the United States.

(b) At no time shall the amount of loans outstanding under this Act exceed the aggregate of $2,500,000,000,000.

(c) No loan shall be provided under this Act unless (1) the city and all financing agents shall have repaid according to their terms all prior loans under this Act which have matured, and (2) the city and all financing agents shall be in compliance with the terms of any such outstanding loan.

REMEDIES

31 USC 1506.

Sec. 7. The remedies of the Secretary prescribed in this Act shall be cumulative and not in limitation of or substitution for any other remedies available to the Secretary or the United States.

FUNDING


Sec. 8. (a) There is hereby established in the Treasury a New York City Seasonal Financing Fund to be administered by the Secretary. The fund shall be used for the purpose of making loans pursuant to this Act. There is authorized to be appropriated to such fund the sum of $2,500,000,000,000. All funds received by the Secretary in the payment of principal of any loan made under this Act shall be paid into the fund. All income from loans and investments made from the fund shall be held in the Treasury as miscellaneous receipts. 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. After all loans made pursuant to this Act have been repaid, the balance of the fund shall be returned to the general fund of the Treasury.

(b) The Secretary is authorized to sell, assign, or otherwise transfer from the fund any note or other evidence of any loan made pursuant to this Act to the Federal Financing Bank and, in addition to its other powers, such Bank is authorized to purchase, receive, or otherwise acquire the same.
NEW YORK FINANCING ACT, 1975

(c) There are authorized to be appropriated such sums as may be necessary to pay the expenses of administration of this Act.

INSPECTION OF DOCUMENTS

Sec. 9. At any time a request for a loan is pending or a loan is outstanding under this Act, the Secretary is authorized to inspect and copy all accounts, books, records, memorandums, correspondence, and other documents of the city or any financing agent relating to its financial affairs.

AUDITS

Sec. 10. (a) No loan may be made under this Act for the benefit of any State or city unless the General Accounting Office is authorized to make such audits as may be deemed appropriate by either the Secretary or the General Accounting Office of all accounts, books, records, and transactions of the State, the political subdivision, if any, involved, and any agency or instrumentality of such State or political subdivision. The General Accounting Office shall report the results of any such audit to the Secretary and to the Congress.

TERMINATION

Sec. 11. The authority of the Secretary to make any loan under this Act terminates on June 30, 1978. Such termination does not affect the carrying out of any transaction entered into pursuant to this Act prior to that date, or the taking of any action necessary to preserve or protect the interests of the United States arising out of any loan under this Act.

Approved December 9, 1975.

LEGISLATIVE HISTORY:

HOUSE REPORTS: No. 94-632 Pt. 1 (Comm. on Banking, Currency and Housing), Pt. 2 (Comm. on Ways and Means);

SENATE REPORT No. 94-443 (Comm. on Banking, Housing and Urban Affairs);

CONGRESSIONAL RECORD, Vol. 121 (1975);
Dec. 2, considered and passed House;
Dec. 3-5, considered and passed Senate.
NYC Seasonal Financing
Act of 1975

1976 - 1978
THE NEW YORK CITY SEASONAL FINANCING
ACT OF 1975

HEARING
BEFORE THE
SUBCOMMITTEE ON ECONOMIC STABILIZATION
OF THE
COMMITTEE ON
BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES
NINETY-FIFTH CONGRESS
FIRST SESSION

DECEMBER 16, 1977
NEW YORK, N.Y.

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(III)
THE NEW YORK CITY SEASONAL FINANCING ACT OF 1975

FRIDAY, DECEMBER 16, 1977

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ECONOMIC STABILIZATION OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
New York, N.Y.

The subcommittee met at 9:40 a.m. in room 5809 of the World Trade Center, Hon. William S. Moorhead (chairman of the subcommittee) presiding.

Present: Representatives Moorhead, Badillo, Vento, Hubbard, LaFalle, McKinney, Stanton, Kelly, and Caputo.

Also present: Representative Edward I. Koch of New York and mayor-elect of the City of New York.

Chairman Moorhead. The Subcommittee on Economic Stabilization will come to order.

Today the subcommittee is conducting a hearing on the financial condition of New York City, with emphasis on the future rather than the past. This is an information hearing only, conducted under the subcommittee’s responsibility for overseeing the operation of the New York City Seasonal Financing Act.

We are considering no bills today, although we expect to hold legislative hearings on this issue early in the new session of the Congress. Let me begin with a brief statement of principle. I believe that a majority of the subcommittee cares, for national reasons, about the viability of New York City, which is the financial capital not only of the Nation but of the world.

We recognize the City’s unique importance, not only to the Nation but to the world at large. We recognize that the possible sins of its leaders should not be inflicted upon the people of New York City. However, as legislators representing the entire Nation, there are certain things we don’t like to see. The aim of the Congress is to get New York City back on its feet and off our backs. However, recent events in New York City have not helped us. The City claims to have made some tough decisions, and no doubt it has. Many believe the decisions have not been tough enough and there haven’t been enough of them.

The City’s budget, while technically balanced in the current fiscal year, is still in bad shape 2 years after Congress voted the Seasonal Loan Act. The evidence is clear:

The City’s own preliminary financial plan for the next fiscal year shows a deficit of about a quarter billion dollars, and that may be an underestimate.

(1)
The City is still paying for some $800 million of operating expenses out of borrowed funds, and there is great doubt that it can return to the capital markets as long as this practice continues. The City continues to rely upon a large advance from the State each year of some $800 million.

There are unofficial reports of long-term projections of revenues and outlays that show the deficit increasing, not decreasing, in the years after fiscal 1979. The City's total budget in the years of presumed austerity has not been reduced but has actually increased somewhat.

The City Council has voted to raise the salaries of elected officials—not a large item of expense but a symbol that hardly squares with austerity. The City's wage negotiations still lie ahead, and the deficit already projected for fiscal 1979 allows for no wage increase. The State is talking about cutting taxes at a time when we in Congress are increasingly convinced that the primary responsibility for the City lies in Albany, not Washington.

I hope everybody here is aware of how difficult it will be to obtain any further Federal assistance from Congress. It is best that we all begin without any illusions. New York City's image, with a large portion of the Congress, is not good.

This subcommittee of the Congress, however, not only wants to help but has not foreclosed on any one variety of assistance if the City and State can demonstrate that further help is deserved.

For example, there is impressive financial reasoning that a onetime, long-term Federal loan may be preferable, from the point of view of the Nation's taxpayers, to a simple extension of the present seasonal assistance.

Lest anyone consider my comments overly harsh, let me reiterate. I care about New York City. I do not want to see the financial capital of the Nation, home to 8 million Americans, drown in its own red ink.

I will strongly support any reasonable plan to help this City restore its fiscal integrity. And I believe that a majority of this subcommittee shares my feeling. But before we can convince a majority in the Congress that continued aid is necessary, you must convince us.

This subcommittee has been, in the past week, in Georgia, Oklahoma, and Minnesota, and there are many problems facing those areas, also, none quite as severe as New York, but I believe if we can start by solving the New York problem, we can then look to the solution of the urban and rural problems that face America with better balance.

And before I call on our very distinguished witnesses, I would recognize our member of the subcommittee pro tempore, Mr. Koch. I would like to first yield to the distinguished ranking minority member of the subcommittee, Mr. McKinney.

Mr. McKINNEY. It is great to be here, Mr. Chairman. I would like just briefly to reemphasize some of the things that you have said.

My friendship—in fact, my close love for the City—is pretty well known from the last time we wrestled with this problem. This was my home. I cannot talk about New York City in the terms of dollars; to me, it is people. It has always been people, and it is the greatest collection of people and one of the most diverse gatherings I think you will find anywhere in this country. New York City is truly the melting pot.
But, I have to say to my good friends, the Governor and the mayor-to-be, that we are going to have a tough time in Congress. As ranking member of this subcommittee and also ranking member of a committee that has to deal with the District of Columbia, I know just how hard it is to get funds for an urban center from Congress as it is composed today.

I must say to you, Mr. Koch, as you are about to take over, that we simply are not going to get aid through Congress with a “budget-of-the-week,” never knowing what the deficit is from one day to another. We are never going to be able to get aid through Congress unless one points to the symbolic pay raises that have just passed the City Council.

We are never going to be able to get aid for New York City unless some changes are made, such as the help Congress gave to the District of Columbia to straighten out its pension programs. There are simply too many things stacked against New York City and what the City has done in the past.

I want to help this City, and I will do everything I can from now through June to help it. I told the former President of the United States—and I am convinced I was right—that his emergency plan, which we finally passed, would never work, that long-term financial help is what this City has got to have. But getting it through the Congress of the United States is going to take such a change in the City’s image that you are going to have a mammoth job to do.

Chairman Moonbeam. The Chair would now like to recognize, possibly for his last appearance as a member of this subcommittee, the distinguished, about-to-become deputy mayor, our good friend, Mr. Badillo.

Mr. Badillo. Thank you, Mr. Chairman.

I can say, as a member of this subcommittee, that no committee in the Congress is more sympathetic to the problems of New York City than this one. I regret that I am leaving it, but I think that it is important that some of us join in making the tough decisions that the chairman spoke of. I hope that in the future I will be on the other side of the desk, together with Mayor Koch, and we will be able to convince you that we are making those tough decisions, and that we will be able to present to you a reasonable proposal that would assure that we do get additional help from you.

And I know that I leave this committee in good hands, because you will be on our side if we can persuade you that it is the right thing to do—and we will persuade you.

Chairman Moonbeam. Mr. Vento.

Mr. Vento. Thank you, Mr. Chairman.

We are pleased to be here, and I commend you for holding the hearings and making available to the subcommittee the expert witnesses that deal on a day-by-day basis with the finances of not just the City but the State.

You have touched most of the sensitive spots in your statement, which I thought was excellent, but I hope that we can quickly move over and above the political to the real-life problems that are confronting the City leaders in New York.

New York City and the problems that it faces and the State are problems that will be and are being faced by other communities, but
on a lesser magnitude, but they will have an impact on this Nation and on the viability, for instance, of the bond market. I think that infrastructure today is not meeting the fiscal needs of urban centers, nor of States. And I hope that we will strive to develop policies, not at the expense of New York City, but for the benefit, not just of the City, but of our other communities that we represent.

Thank you, Mr. Chairman.

Chairman Mooney. The Chair would now like to recognize the ranking minority member of the full Banking, Finance, and Urban Affairs Committee, the distinguished gentleman from Ohio, Mr. Stanton.

Mr. Stanton. Thank you very much, Mr. Chairman.

Maybe at the outset we could put aside something that we will hear in the future—and we have heard in the past, especially a couple of years ago, about the importance of New York City and its financial problems to the Nation. While we have heard a lot of rhetoric, I think, Mr. Chairman, it is important to point out that you have had 10 members of your subcommittee come to New York City. I think that is the most we have ever had, except on rare occasions, in Washington, D.C. So, I think it is pretty evident that this issue is quite important.

I would also like to thank you, Mr. Chairman, and members of the staff for the excellent work you have done in the last 2 years in keeping us abreast of the problems that have gone on.

Coming up to New York and seeing the new mayor, our friend, Mr. Koch, and serving as I did with the Governor, it is like coming back home. I represent, of course, many of those who were on the fence last time. We carried President Ford’s program by 10 votes—213 to 203.

I would be less than candid to say that we, indeed, will have a tough time. The odds are less than 50-50 that we can get a bill through next June. I, personally, enter the hearings with an open mind. I think that only, in closing, I could emphasize to my friend, Ed Koch, that the most important thing you can do would be to start immediately—which I am sure you plan to do. I am sure that whatever you do as far as bringing the finances of the City under as tight a control as you possibly can—will have a great effect, along with traditional aid from the State of New York, in convincing Congress that at least they should continue this program in a phaseout for a few years to come.

I think that is the most important thing you can do, and don’t ever come to us with “what we are going to do in the 1978 budget.” Start immediately, the best way you can.

Thank you very much, Mr. Chairman.

Chairman Mooney. Mr. Hubbard.

Mr. Hubbard. Thank you, Mr. Chairman.

This is a thrill for me, personally, to be in New York City, as this is the first time I have ever been to New York City since I was a teenager, that was one trip when I was 17 years old, and I am thrilled to be here in our Nation’s largest City.

I have been a skeptic and an opponent of Federal aid to New York City. One reason is because of a questionnaire that I sent to my own
constituents and questions I asked from time to time at various meetings which indicate that 96 percent of my western Kentucky constituents oppose Federal aid to New York City. We also have 96 percent of our people who believe in God, but they do have that many who do not believe in Federal aid to New York City.

But I would say this, that certainly I continue to have an open mind about the problems of this great City. I would say that in the year 1978, in the second session of this Congress, that New York City's chances for continued Federal help will be enhanced by the fact that your distinguished and great Governor, Hugh Carey is a former House Member and a friend to many of my colleagues and to me. Indeed, your next mayor, Ed Koch, is one who is highly respected by the Members of Congress, and his influence with this Congress and this subcommittee will be substantial. Surely, the deputy mayor-to-be, Herman Badillo, a member of our own subcommittee—his influence will be great. So, I think New York City's chances are enhanced by the fact that your Governor and your next mayor and your next deputy mayor are former Members of Congress for whom we have much admiration.

Quickly, to give you the views of my own constituents—I represent a rural area, as I said, in western Kentucky, I have already said that about 96 percent of my people do oppose Federal aid to New York City.

For example, in my hometown, a small town of 12,000, we pay a beginning fireman $7,548 a year; I understand that a fireman in New York City starts at $12,600.

In my hometown, a policeman can expect a beginning salary of $6,974 whereas his counterpart in New York City can expect $12,900.

I understand that you pay your street cleaners in New York City more than we pay our schoolteachers in western Kentucky. But my hometown is not an isolated town. Many of the Members of Congress come from areas such as I do. My hometown is not unfamiliar with fiscal problems. Over the past year the budget has increased by approximately 17 percent, but we have not had to turn to an elaborate debt-financing scheme or book-juggling for answers to our problems. Taxes have been increased, and although these increases have been burdensome, they were needed to take care of our own.

In closing, Mr. Chairman, I would say that, again, the people across the country, including my own constituents, are being asked to take care of New York City, and they will probably be asked to take care of other cities in the future. That is their main fear.

I do not think it is fair to ask taxpayers across the Nation to take the great responsibility, which is not theirs, without the State of New York and the City of New York trying to do everything they can within reason to answer the problems of this City.

Thank you,

Chairman Moorhead, Mr. Kelly.

Mr. Kelly, Mr. Chairman, what I would like to do is ask permission of the subcommittee to make a part of the record an opening statement that I have and just add briefly some oral remarks.

Chairman Moorhead. Without objection, that will be made part of the record.
[The opening statement of Congressman Richard Kelly follows:]

OPENING STATEMENT OF HON. RICHARD KELLY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA AND MEMBER OF THE SUBCOMMITTEE ON ECONOMIC STABILIZATION

In an unprecedented move three years ago a reluctant Congress agreed to bail out the Nation's number one city from the brink of bankruptcy by committing large sums of the Nation's tax revenues to a one-shot series of seasonal loans aimed at getting New York City back on its feet.

Implicit in this agreement was a commitment by New York City to use this three-year bailout period to set its fiscal house in order and to make every effort to reenter the securities market which had been closed to the City because it had overborrowed and overspent way above its ability to repay.

Implicit in this agreement was a commitment by New York to leave no stone unturned in ferreting out wasteful programs and management practices that helped destroy the fabric of this great City. Self-sacrifice and belt tightening was the order of the day.

The purpose of our hearing today and in subsequent weeks is to determine how well New York has risen to the challenge of survival. This is a crucial question for the Nation as a whole because in agreeing to help New York City, Congress has set a dangerous precedent for other urban areas experiencing similar problems. The taxpayers of this Nation need and deserve to know if the results in New York City were worth the risks.

Clearly, there has been much talk of progress in accounting procedures; reduction of workforce; and an effort to phase budgetary gimmickry out of the City's bookkeeping system.

However, recent events and other information made available to me since the loan agreement went into effect, raise serious questions about the sincerity and depth of effort on the part of New York City politicians to get the City back on its feet.

I submit some of the key questions for the record in the hope that they will be answered during the course of the hearings.

The layoff of approximately 60,000 city employees since 1975 is a well-publicized statistic that is given top billing in any account of New York's spartan effort to trim the fat. A more elusive figure is the number of workers that were rehired during the same period to work for the City under federal CETA and State programs.

According to the U.S. Labor Department Office in New York City nearly 3,500 have been rehired under CETA, the federal job training program, as of October 3, 1977. Other estimates cite vastly higher figures.

If this is the case, the layoff statistic is not a meaningful reflection of the real efforts being made to cut back on the City's bloated workforce. Accurate statistics on the number of City employees that have been rehired since the crisis to perform largely municipal functions regardless of whether they are on City, State, or Federal payrolls, would be a meaningful determinant in these deliberations.

Mayor Beame's $249 million deficit projection for fiscal 1979 appears to have little connection with harsh reality. It does not take into account wage increase demands that are likely to erupt in the spring after a two and a half year technical wage freeze. Wage increases for municipal workers, most of whose contracts are up this year, may carry a $300 to $500 million price tag that has not been taken into account in the 1979 budget.

Deficit figures do not include the $800 million plus in operating expenses tucked away in the capital budget, nor the $500 million in advances provided to the City by the State and Federal governments on an alternating basis to cover costs. Question: How is New York City going to face up to its real deficit if all its projections are based on unrealistic assumptions?

One of the most disturbing developments of the past week was the announcement that City Council has voted overwhelmingly to give substantial increases—some as high as 50 percent—to the City's top 51 incoming elected officials. By seeking whopping salary increases for themselves, these politicians have bartered away any moral right to expect moderation from union officials when they come to the bargaining table this spring.
Apart from the purely technical questions, there is a fundamental concern about whether or not there has been any change in the manner in which New York City is run to warrant any optimism for improvement in the future.

New York is still one of the Nation's leading commercial and cultural centers. It is still one of America's richest cities. But because the people have lost control of their government, many areas of the City are in a state of decay and many areas are dead.

The streets are in disrepair. Although the payrolls have been reduced somewhat, they are still glutted with employees, getting paid more than the City can afford, to do less. Crime and lawlessness continue to be a threat to every person.

All of this is primarily the result of government by special interest. Politicians currying favor with special interest groups representing welfare recipients, labor unions and a large anti-tax constituency, have locked the City into programs that continue to sap the strength of the City. Unless these programs are changed—and soon—New York City will continue to atrophy. And its people, once a productive and vibrant element in the Nation's economy, will be forced into nearly total dependency on the governmental handout.

In a time of fiscal crisis unionized municipal workers continue to reap the highest wages in the land when the fringe and retirement benefits are factored in. For every $3 it spends on base pay, New York City spends up to $2 on fringe benefits.

Second only to Washington, D.C., in per capita expenditures, New York City continues to outspend the average American city by 46.5 percent. The most recent figures list New York City's annual per capita expenditures as $3,044 compared with $850 for Baltimore, $651 for San Francisco, $443 for Philadelphia, $343 for Boston, $365 for Chicago and $488 for Cleveland. The latter two have drastically lowered per capita figures because they do not offer the broad range of services that are available in New York. Will New York City attempt to bring its spending more in line with what other cities are spending in the near future?

Aggregate New York City expenditures on employee health care grew by 5,500 percent from $8.5 million in 1961 to $491.4 million in 1976. The city worker doesn't contribute a cent. Is this type of generosity justifiable in view of the current fiscal crisis?

Public assistance grants in the City and the State are the highest in the country. The City's caseload has grown by 370 percent since 1971. In July 1977, the average monthly payment for a family of four receiving aid to families with dependent children was $378.70. In Georgia it was $104.39; $209.59 in Ohio; $227.46 in Michigan; $236.95 in the District of Columbia; and $182.57 in Maryland; $273.60 in Minnesota; $265.57 in Oklahoma and $47.42 in Mississippi.

One commonly heard refrain with regard to the high level of welfare payments in New York City is the fact that the State has the major responsibility for determining the size of the grants. However, since New York City's residents comprise one third of the registered voters in the State, they exercise considerable clout in this matter.

High taxes to pay for these spending programs are eroding the City's economic base and driving taxpayers and business out of the City. Between 1960 and 1975 half a million manufacturing jobs left the City.

Landlords, unable to maintain their rent controlled structures, are abandoning them to rats, vandals, arsonists, and government ownership. Vast areas of New York are peopled by vacant apartment houses.

The cumulative subsidy by landlords to tenants in rent controlled housing has exceeded $20 billion, and tax losses resulting from City takeover of abandoned apartment buildings are in the millions annually. And yet politicians consistently choose to ignore this constant drain on the City's economy.

Amid all this—in almost a pathetic way—there is talk about the financial rebirth of New York based on revitalized private investment to provide the City with jobs and prosperity that will benefit its people.

But every person in New York has got to know that the billions of dollars in private investment that are represented by every one of those ravaged or abandoned shops and buildings is a monument to the danger that exists for any private investor in New York City.

I hope this aspect of the New York City problem will get the full attention it deserves during this and any forthcoming hearings.
For without a healthy economic base, and elected officials ready and willing to serve all the people of New York City—any superficial belt tightening measures will be straws in the wind. And this great City will collapse.

The nonsense that New York, the richest City in America, needs help must be recognized. New York politicians are asking the federal government to do for the richest City what we don’t do for the smallest, poorest, City in America. We are asking in effect the poor to help the rich live beyond their means.

Mr. KELLY. Thank you, Mr. Chairman.

Mr. Chairman, I think that this is a good time for the subcommittee to try and put into perspective what it is we are really doing here, and not to lose sight of the fact that it takes a pretty good sense of humor to hear in the broad daylight and with the Nation watching, to try and explain why the richest City in America is asking for help from all of the cities that are less affluent. The other cities in the Nation simply have nowhere near the assets of New York, and they have all of the problems, and it is just the way that New York is handling their problems that creates the difficulty.

So, I think if we will keep in mind that the rich are coming to the poor for help, we will have the whole problem in its proper perspective. They have the money, but they are just living beyond their means, and there seems to be no question about that, because they keep scurrying around saying they are going to try and quit living beyond their means but they just haven’t quite gotten around to it yet.

So, this, then, being the reality of the situation, I appreciate the opportunity to participate in the hearings, and congratulate the mayor on all of the opportunities he has for greatness.

Thank you, Mr. Chairman.

Chairman Moorehead. Mr. LaFalce.

Mr. LaFalce. Thank you, Mr. Chairman.

My two previous colleagues have said a number of things that I would like to make, in my brief remarks, comment upon.

My good friend, Congressman Carroll Hubbard, indicated that his constituency was overwhelmingly opposed to assisting New York City. Well, I would go back to 1975 when I was the only New Yorker on this subcommittee. The Tonawanda News cartoon had Congressman LaFalce behind closed doors with all sorts of mail outside the door—all opposed to aid to New York City—while saying behind closed doors Congressman LaFalce was plotting to help New York City. It is not unusual, but we have a responsibility to lend our constituency, and I think that we led them in 1975 in giving assistance to the City, and I think it is going to be incumbent upon us to do that same thing again.

And my friend from Florida, Congressman Kelly, said we have got to keep things in perspective, and I think we should keep things in perspective, too, about the present order of things in New York State. And I would like to give you a little bit of perspective, because I also served for 4 years as a State legislator, and I am aware of what went on in New York State, not only during those 4 years, but for the past 16 years prior to Governor Carey’s taking office and what has gone on for the past 3 years since he took office. And I think it is important that we have that perspective to know what the present administration inherited, how we got to be where we are.

In 1960, for example, the disparity between New York and the Nation in State and local taxes per $1,000 of personal income was 115 percent of the national average. By the time the Governor took office,
it was 141 percent, an increase of 26 percentage points, or more than double the disparity—more than double. That is what he inherited.

The weight of supporting the public sector in New York, measured in terms of combined State and local expenditures, as a percentage of personal income, which had consumed an amount equal to 13 percent of personal income in 1960, by the time the Governor took office, doubled its share and was equivalent to 26 percent of personal income.

Even more significantly, the disparity between New York and the rest of the Nation rocketed from 3 percent in 1960 to 36 percent by the time the Governor had taken office, by which time New York was allocating fully one-third more of its income to the State and local sector than the rest of the Nation.

Most importantly, between 1960 and the time the Governor took office, private sector employment grew less than 3 percent, whereas public sector employment grew by more than 50 percent. When the Governor took office, he inherited a projected deficit of $800 million. He inherited crises with UDC, with New York City, and so forth.

In the past 3½ to 3 years, however, we have been able to stabilize the situation in New York. We now have a comfortable balance, perhaps even a surplus. Interest rates in our State borrowings have become competitive; municipalities have been able to achieve substantial debt service savings by refinancing issues originally brought out in extraordinarily high interest rates, and so forth.

We are now at the point where we can do what is the most essential thing to make us in even better competitive situation, to improve our economy even more, to therefore improve the situation in New York even more, and that is, cut New York State's taxes. They have become so high, it is imperative, in order to stabilize our private sector, that we cut taxes in January or February of 1978. I want to praise Governor Carey for bringing us to the point where we will be able to do that.

And also, while New York State has done a lot in the past 3 years, it still has a lot more to do. I personally hope that the State, not the Federal Government, and the City, not the Federal Government, will become more involved in addressing the problem of rent control in New York City.

Insofar as the Federal Government is concerned, it is essential that we identify those Federal policies that have worked against the distressed regions of this country; to wit, New York State. And we can identify them point by point. It is imperative that the new urban policy that we have give Federal money where the need exists, and we can document where that need exists; that we target our Federal programs as we did with the community development bill that came out of this committee, as we did with a certain Federal procurement policy, and as we ought to do with our tax policy, via a bill sponsored by Governor Carey, introduced by the dean of the New York delegation, Congressman James J. Delaney, and cosponsored in a bipartisan manner by 30 out of 38 New Yorkers, 10 out of 11 of our Republicans, and recreitably only 20 out of 28 of our Democrats, and we have got to work on that.

So, there is a lot to be done still, in New York State and in Congress. But let us not forget how we came to be where we are, and let's not
forget the great steps we have taken in the past 2½ to 3 years since Governor Carey took office.

Thank you.

Chairman Moorhead, Mr. Caputo.

Mr. Caputo. Thank you, Mr. Chairman.

I would like to welcome the non-New Yorkers to New York. And, like Mr. LaFolice, I would like to try to put some perspective on what we are here today to discuss.

Language like "aid" and "what New York City has been given" and "what kind of help we need," language like "taking care of New York City," I can accept as long as it is understood that this program has returned handsome profits to the Federal Government.

The Federal Government borrowed money to relend to New York. It cost the Federal Government $143 million to borrow that money. New York City has paid the Federal Government $166 million for the use of that money. All repayments have been made on or before time, in full, with interest.

The gross profit of $23 million that the Federal Government made on this loan program has to be reduced by the some $3 million that it might have cost the Federal Government to run the loan program, certainly no more than that. So that the Federal taxpayer has enjoyed a $20 million profit on this exchange.

Far from being a drain on the Treasury or a burden on the taxpayers of western Kentucky or Florida or anywhere else, this has been a program that helped those taxpayers. And what the City and State have asked for, the New York State congressional delegation has asked for, is the privilege to make another $20 million for the Federal Treasury. If you want to call that a drain, I can accept that. We are grateful to have it. But don't confuse the impact it has had on the rest of America.

Second, I think it is important to discuss the City councilman and other City leadership pay increase. Previously, I chose not to comment on that since it is not my direct responsibility. But I went back to Washington yesterday, as most of you did, for the first time since that pay increase; and as the only remaining member who represents part of New York City on this subcommittee, now that Mr. Badillo is leaving, I was the subject of some pretty direct criticisms about that pay increase, and I decided it had become my business.

Mr. Koch, Mr. Badillo, Governor Carey, I was, as Governor Carey knows, in the State legislature when the Emergency Financial Control Board legislation went through Albany, and on the Ways and Means Committee where it was in part composed. And after careful study it was my opinion that the money involved in the pay increase was not part of the approved financial plan and, hence, under law, must be reviewed by the Control Board, and the Control Board has the option to overrule the pay increase, and it would be my hope that the Control Board will exercise its requirement to review and its option to reject the pay increase. Not, as others have indicated, because that is a significant amount of money, but because symbolically, it is devastating to those of us in Congress who are trying to extend Federal loans.

Mr. Chairman, I would also like to add that those in the Congress who sought, No. 1, to protect the American taxpayer and, No. 2, to
restore fiscal discipline to a major metropolitan area in voting for the original seasonal loan, have achieved their objectives. Far from damaging the taxpayer, as I have indicated, it made the taxpayer money. And No. 3, the City has made substantial progress toward restoring the kind of fiscal integrity that we ought to have.

During the period ending—the 5-year period ending 1975, the debt of the City of New York was growing at about 20 percent a year, far beyond what it could sustain. The seasonal loans were made that year, and since that time, that astronomical growth and debt has stopped, and more recently the total debt of the City has declined for the first time in my lifetime.

The deficits that the City was running, also out of proportion to what the City could afford, although not fully under control, are substantially less than before Federal involvement and increasingly coming under control.

The number of employees the City has been drastically reduced. Some 25 percent of the social security numbers that were on the City payroll at the time of the first seasonal loan are no longer here. Not all of those are layoffs; some are attrition, some are deaths, some are voluntary retirements. But I don't think you will find another school district in the country that ever laid off approximately 25 percent of its teachers. I don't think you will find another police department that laid off 21 percent of its officers, a fire department that laid off 20 percent of its officers.

Extraordinary sacrifices have been made. Maybe more have to be made, but don't forget the progress this City has, indeed, made. There were complaints about our transit fare. Well, that has gone up 40 percent since the seasonal loan program started. There were complaints about free tuition. A nomenclature problem—it never was free, but there is tuition at the City University now, and the cost to the average student of going to the City University has gone up 125 percent since the seasonal loan programs began.

Mr. Chairman, I would like to close with the hope that the members of this subcommittee will go away with an understanding that the City is not asking for something for free. We pay dearly for those loans, far more than it costs the Federal Government to provide them.

And second, the City has made substantial sacrifices, and I was hoping that instead of this dry, formal hearing context, sometime some of you could come to my part of the Bronx and sit with me in a classroom designed for 25 students where 40 attend and the children sit in their overcoats and mittens because we are trying to save oil that costs so much, and visibly, emotionally feel the sacrifices this City is going through to pay for its transgressions of the past.

Chairman Moynihan. The Chair would now like to recognize as a Member of Congress, although not a member of this subcommittee, a gentleman that we all admire greatly.

Before I recognize this gentleman, I would like to pose the question, which could also be posed to Governor Carey and Mr. Badillo, that why would a Member of Congress leave the active role of being a Member of Congress for the contemplative role of being mayor of the City of New York? [Laughter.]

Mr. Koch, we are delighted to have you with us and wish you well in the future.
Mr. Koch, Mr. Chairman, I appreciate the opportunity to be with you. As you know, I served on the Banking and Currency Committee with you and with other members of that committee; it was a very good experience for me. I enjoyed it.

I also want to thank you for coming to the City, in the large numbers that are here today, and to welcome you and to hope that in the short time that you are here you will see more of the City and enjoy what this City has to offer.

I also want to thank you for permitting me to sit on this side of the table instead of being interrogated, which I will have an opportunity to be subject to in January, when I become the mayor.

Let me tell you why I think things will be different. First, I want to thank the Congress for having assisted in the past, but to tell you in a very general way without the specifics why we desperately need your continued, ongoing assistance at this time and why you can put your money there and not be fearful.

I come to this office totally politically unencumbered. The normal special interests—I am not speaking in any pejorative way—that elect a mayor and have elected mayors in the past have no hold on me. They did not help me. I got here without them. I got here without the unions and without the banks and without the political organizations that normally have great input into the selection of the mayor of any city, and so whatever has to be done to make certain that we live within our means and that we engage in only those activities that normal, rational people engage in who lead cities, that will be done.

I also want to assure you that there will be an examination of the City’s budget that will take place in a very painstaking way so as to eliminate incompetence and corruption and the use of services that perhaps are not necessary. Or if ultimately what is required to balance our budget is the layoff of individuals, as painful as that is to the individual laid off and to the mayor who lays them off and to the people of this City who lose the service that they need, it will be done.

I unhesitatingly say to you and pledge to you that there will not be any hesitation to make the hard decisions, no matter what the political flack is. It is of no consequence to me.

I know that may sound arrogant. It is not intended that way. But I also know the reason I am here today is because the people heard me say the things that I am saying to you, believed what I said, and elected me because of what I said. And I will not fail them, nor will I fail this Congress if it places its trust in me and the credibility which I hope to restore for the City of New York.

When, in the future, the City of New York issues a statement or any statement is made on behalf of the City, you will be able to rely on it. There will not be gimmicks employed in any budget that I sign off on. Nothing will be overstated or understated. Whatever the City issues by way of a statement, you will be able to rely on.

Just to close, the past is the past. The future is with us. I need your help to make that future something that the people of this country will say we were pleased to be a part of. New York City is no worse, no better than any other city in this country, but it is different. It is different. It is the largest City. It is the City that people view as the capital of the world. It has every problem, but enormous in scope. Because
it is the capital of the world and because it is the City in the United States that everyone has a stake in, we have to somehow or another get across to the people who live in the United States that this City belongs not only to those of us who live here—New Yorkers, if you will—but to every citizen of this country. We all have a stake in making it survive, and I know you will help.

I thank you.

Chairman Moorhead. The gentleman from New York sounded less like a Congressman and more like a mayor. [Laughter.]

Mr. Koch, let me say that I think the success of legislation, Federal legislation, will be because those of us who have learned to know you, will trust you and because we have trusted you in the past.

Before I call on the witnesses, I wanted to alert the members to the ground rules that I think are necessary for this hearing. I have been sometimes accused of being the slowest gavel in the east. Today, with 10 members present, 6 witnesses in the morning session, I have got to be one of the fastest gavels. So, we are going to have a stopwatch, which we have never had before, and adhere rigidly to the 5-minute rule, because that is the only way we can be fair to all members.

And so I thought as you are listening to the testimony, you can be thinking about how you phrase your questions in the briefest possible fashion.

The subcommittee would now like to hear from our distinguished former colleague, whom we know, love, and respect, and who has done such a fantastic job, faced with the most difficult problems, of really turning New York State around and putting it back on its feet.

Governor, we applaud you and look forward to hearing your testimony.

STATEMENT OF HON. HUGH L. CAREY, GOVERNOR OF THE STATE OF NEW YORK

Governor Carey. Thank you, Chairman Moorhead.

I have been sitting here contemplating and, of course, carefully paying attention to the wisdom and prudence and eloquence of the members of the subcommittee and yourself. It is a unique experience in these rooms where the Emergency Financial Control Board meets, because I am sitting now where an observer would sit and you are sitting where the mayor would sit, and Mr. Badillo is sitting where the Governor would sit. Here is where we have been in the public eye, making the decisions, reviewing the facts in these public sessions, and, indeed, have had the observations of Members of Congress and the total surveillance of the Treasury officials, all during the period of the seasonal borrowing system that was adopted back in 1975.

So, I think that the solution that you will find to the financial problem of this City and the like financial problems of the country will be best achieved when those parties are in continued cooperation—namely, the City and the State and the Federal Government—all seeking a permanent solution to these uncertainties and formal assurances of the kind that can give the taxpayers a long-term monitoring system that is in place and that will be a security factor in terms of whatever decisions and whatever plans are worked up for the City, State, and Federal Government.
We are going to work closely with the City of New York. We, in this State, along with the mayor-elect and the team that he represents, with Council President Bellamy and Mr. Goldin, who has been on the Control Board, have been careful, and will continue to be careful to observe the self-governing nature of the local political institutions.

There will be a continuing because the new executive director of the Control Board will be Mr. Donald Kammfeld, who is presently the first deputy mayor of New York. He will bring to the Board his detailed knowledge and broad skills in City finances, so we will be able to timely submit the kinds of plans that will be the basis for negotiation with the Federal Government on what we hope will be a common plan, because Secretary Blumenthal has indicated his willingness to have the Treasury Department work with the City and the State in the preparation of a common plan for submission to the Congress.

As we gather today, you are in a very vital, exciting City, but let me hasten to correct any illusion of great wealth. We are really not in the City at the moment. We are sitting in the towers of the New York-New Jersey Port Authority, the Trade Center. And this is a construction which was undertaken at some time in the past, and we are in a place where we hope someday world trade will contribute heavily to the benefits of our City.

But we are here today not to talk about illusions of great wealth. We are here today to talk about the efforts we have made and the kinds of efforts that have been made in the Federal Government.

Seasonal financial assistance has worked, of course, as Congressman Caputo has said, to the benefit of the Federal Government, and we are pleased to make that contribution. But the exercise that we have had to undertake has been of benefit to the Federal Government as well, because we took the lead in containing welfare and medicaid costs. We are the only State that had, not a 22-percent annual increase in the cost of medicaid, but a flat 1-percent reduction in those costs, without painful losses to the medicaid recipients. And we have had assumptions, and we have had aspirations, as well. We have hoped and we believe that part of our problem can be solved when the Federal Government comes to the point where you begin to assume, at least, the local cost of welfare. We have not received it yet, but we are grateful for the prospect of fiscal relief obtained for New York by Senator Moynihan that will be of benefit to us in the long term.

What we cannot afford, Mr. Chairman, is the continued loss of business, jobs, and people that will cause a continued and irreversible erosion of our tax base and put the health of our City beyond recovery, and that is why our State, suffering from an enormous debt caused by fiscal gimmickry and mismanagement and excessive borrowing and the highest level of individual business and corporate tax in the country, never recovered as quickly as did other States from the recession of 1974-75.

So, let me tell you now what the State has been doing with the City since 1975, aside from supplying, if you will, the presence here at the Control Board as required by the statute that created this board.

The seasonal loan program, yes, produced a profit for the Federal Government, but the State, at extreme risk to its own credit standing, stepped in and advanced the City $750 million in aid.
In addition, the State created a rolling $800 million State advance, which has been continued in each succeeding year. We used our credit, through MAC—and you will hear from the chairman of the Municipal Assistance Corporation, Mr. Felix G. Rohatyn—to provide more than $3 billion of advance financing to the City, and that is increasing.

Now, those emergency efforts to assist the City with its financing have been costly for the State and its taxpayers in the short run because of increased costs to the State's own borrowing. In fact, while the City was in great difficulty, the City could not borrow, yes; but the State had markets closed as well, and we had to undertake a refinancing of over $6½ billion of State agencies that were in debt and notes that had to be met and bonds that had to be issued, and a $4 billion annual financing to provide to localities the school aid and other kinds of aid they need.

So, we achieved these things while markets were closed to both the City and the State, and we secured the reopening of those markets, and the decline in interest costs that was of benefit, not only to New York, but to other municipalities and localities around the country.

Today, I want you to know that the City is back on the way to recovery, providing we stay on this path of austerity, and as Mayor-elect Koch has said, take measures that are necessary to make the belt tightening even more secure.

The people that I have visited all over this State have a renewed confidence in the State and in themselves because they know—and the world should know—that the State of New York meets its obligations. With the help of the State comptroller, the credit of the State has not only survived, but has been strengthened by renewed confidence in the State's finances and the assurance that the State will not allow its localities to default on their obligations.

This isn't the only locality which is in trouble. Yonkers very nearly went into default. I could name school districts in a number of cases that would have gone into default had not the State stepped in and secured their credit during the time when there was uncertainty.

We have a balanced State budget. Beyond any question, we submit a financial statement for analysis by those interested in those things in the country that is exactly the kind that is the basis for corporate or other kinds of borrowing, and through that careful management of the State's finances, we lowered the cost of the interest rate to the State by about 3 1/2 points in 1 year alone.

Here are some of the things that the State is doing that were never done before.

To help in the operating expenses and costs of the City of New York, the State is assuming 75 percent of the operating costs for the senior colleges and the City University, saving the City about $54 million.

In addition, our State's tuition assistance program contributes about $45 million for tuition payments to that City University to the students who need those payments and without which they could not attend the City University.

We will assume 50 percent of the operating costs of the courts of New York City, amounting to about $28 million. This year the City will receive $19 million more than last year under State aid for ele-
mentary and secondary education. The State will share 50 percent of the impact on City revenues of the phaseout of the stock transfer tax, a transfer tax which had to be eliminated, or we would have lost a basis for the tax itself and the jobs that provide the tax. That will amount to about $120 million which the State will be supplying to the City.

In each State fiscal year since 1975–76 the State has given additional aid to the City, even while the State was containing the growth of its own budget.

Since I became Governor in 1975, I have kept the growth of the State budget to around 4 percent, below the level of inflation, in order to restore the fiscal credibility of the State.

The size of the State budget has increased by only $300 or $400 million each year since I became Governor; yet, in each fiscal year we have increased our aid to the City by about $200 million.

The State has not hesitated to share its limited revenue growth, therefore, with the City. In State fiscal year 1973–74, State aid to New York City amounted to about $2.4 billion. We estimate at the close of this current fiscal year, in March 1978, State aid will be about $3.16 billion, an increase of 34 percent during a time of fiscal difficulty for all of the people of the State.

New York State has done its share for New York City, and we will continue to do our part. But this State has limits on its ability to help. The budget of the City is larger than the budget of the State by 20 to 25 percent, and our State taxpayers have suffered for years from heavy taxation that has done nothing but damage the competitive ability of New York to keep and attract businesses and jobs.

But this year we were able to at least parcel out a modest income tax cut for the first time in 57 years, and I anticipate being able to propose further tax reductions for individuals and businesses in 1978.

The tax cuts I intend to propose, Mr. Chairman, are absolutely essential to the economy of New York State and New York City. We have no alternative but to reduce these taxes with what flexibility we have. Even with tax cuts in 1978, our level of taxation will be too high.

At this point in our recent economic history, the best thing we can do for the City is to rebuild its economy and the State’s economy. Both are dependent upon a strong and competitive City and State.

The limited flexibility we have is best understood in the monthly report just issued to the underwriters, which incorporates the revenue anticipation figures and our collections, and is authored by the comptroller of the State and the budget director.

They reported that for November the State has a positive cash flow and that we currently anticipate an $18 million surplus at the end of our fiscal year in March. Every nickel of the surplus will be reported to the public in my budget message for 1978. The businesses and citizens of our State have long suffered the kind of high taxation which has, frankly, caused the economic departures that you heard about in Congressman LaFalce’s analysis of where the jobs have gone and how the corrective measures were unfortunately to increase jobs in the public sector.

It is now imperative that we talk of tax cuts in New York. We are not talking in terms of a reduction of the proportion that is being contemplated in the Congress, but we are talking about something which
will be a significant and a symbolic gesture, at least, to business to remain in New York City and New York State, to locate or relocate in New York if that's possible, to provide the jobs we need so badly.

That signal that we want to send forth that New York State and its government will meet its obligation to individuals and localities, is one that must be accompanied by a recognition that our taxation is, indeed, insufferable and beyond our endurance.

But lower taxes are only a partial solution, and to use a metaphor, they will do no more than move the patient from the intensive care unit to the critical convalescent ward. So, any idea that we have a huge bonanza coming forth here to the City of New York or the State of New York will simply not square with reality.

What is needed? What is needed to remove the uncertainty that you will have to contemplate and deal with your constituencies, and a recurrence of those uncertainties, is a permanent solution to the fiscal recovery of this City. I know with the new leadership of Mayor-elect Ed Koch and his team and with the intensive efforts he has planned for the City, this City will make the effort to create the necessary fiscal plan for economic restoration.

I want to add a cautionary note here, however. In my testimony before this subcommittee in October of 1975, I said:

The sacrifices the citizens of New York must make must be viewed in light of an important point brought out by a recent study issued by the Congressional Budget Office. That report, requested by the chairman and members of this subcommittee shows that the citizens of New York, contrary to most public opinion, do not enjoy a level of services far above the citizens of other cities.

The report stated, and I quote:

Yet, this is a misleading conclusion which stems from the fact that New York City provides services that in other areas may be supplied by a county government, a school district, or another specialized government. If one compares the New York employment and spending patterns with those of all the local governments providing services to the residents of other large cities, New York appears to be less extraordinary.

That quote is even more valid today. Demands on New York for further sacrifices must be critically considered in the light of our pressing need for help, but we are not here to ask for special considerations, handouts; we have never asked for handouts.

As Congressman Caputo has said, we have repaid promptly and with interest the loans we received under the seasonal borrowing.

What we are asking for now is a joint Federal, State, and City fiscal compact that will provide the guaranteed and predictable long-term financing the City needs in order to set sure priorities and to rebuild our economic infrastructure. Indeed, it is likened to the case where, instead of getting along month-to-month on a billpayer loan, if you want to finance a mortgage to build a house or modernize a property, you need a mortgage, not a short-term loan.

In my view, the most efficient mechanism for the long-term refinancing of New York City would be some sort of federally guaranteed expansion of the borrowing powers of the Municipal Assistance Corporation, which has worked enormously well. It is one of the first of its kind in this country, and is the kind of remedy which has shown that bringing in the private sector management and leadership and work-
ing with the public sector responsibilities, this kind of State agency has been able to refinance the debt of the City, keep it going, and bring down the cost of that debt.

Now, these are some of the things that we asked for 3 years ago. And, indeed, this subcommittee and members of it considered other alternatives to the seasonal borrowing, which was eventually granted by the previous administration. Had your bill or some version of that assistance been enacted, we would be better off today, and a long-term guarantee would have had less impact on the Federal budget.

If a Federal-State-City fiscal compact were achieved, then the seasonal loan program could be scaled down and phased out over a relatively short period of time. Federal participation in a long-term financial program for the City will enable the City to begin to market on its own short-term notes in modest amounts beginning, perhaps, in the summer of 1978.

Once the City can begin to make capital investments, begin to borrow again, the work of rebuilding the City can proceed at an accelerated rate, and that is much needed because of the age and heavy use of the City's physical plant, such as the century-old water mains and the roads and bridges that are in desperate need of maintenance.

Once the City can reenter the financial markets, it can begin to restructure its own debt and begin to relieve its taxpayers of the crushing load of debt service which does nothing but drive up real property taxes, and that, in turn, drives businesses and jobs out of the City and the State.

There are 18 million people in the State, and we have come a long way since the difficult days of 1975, when the City and State were threatened with terrible uncertainties. We have done much for ourselves and we have had timely help from the Congress and the Federal Government. Now, we seek a permanent solution for this City's needs, and one agreeable to all parties and one useful to other localities around the country.

To find that solution again, I say, perhaps we need to look at the original legislation that your committee reported out, a bill that would have provided both short-term and long-term assistance to the City. If we could begin there, then we can begin to plan together to restore the largest, yes, and the greatest City in our Nation, to rebuild its physical plant, to put people to work, and to rebuild the economy so our citizens can have the jobs they want and need.

We make a legitimate claim for the kind of assistance that will allow us to do what we have been doing for 3 years—to meet our obligations on time, to return the dividend to the Federal Government in terms of a better economy, to make ourselves self-reliant, and to be worthy of the leadership that comes to us now, prepared to do the job.

Mr. Chairman, it is, indeed, a thrill for me to be back among the members of this subcommittee, to welcome you to New York City, not as it has been, but as it can be, with your cooperation.

Thank you.

[Governor Carey's prepared statement follows:]
Chairman Moorhead, Distinguished Members of the Committee, Mr. Koch, I am glad you chose to hold these important hearings in New York City.

It is important for you to see for yourselves the progress New York has made in the past three years, and it is equally important for you to have a clear sense of what remains to be done.

I am glad to see you here in these particular rooms where the Emergency Financial Control Board holds its meetings. The Control Board or some successor agency is one of the most important elements in any long-term solution to the financial problems of our City.

We fully recognize the need of all the parties -- Federal, State, local, and private -- who are interested in a permanent solution for the City's uncertainties, to have the formal assurance that can only be given by a long-term fiscal monitor.

As Governor, I am Chairman of the Control Board. Mayor-elect Koch will sit on the Board as Mayor. He and I will work closely together to evaluate the role of the Board, and propose Legislation for its successor, while at the same time, maintaining the self-governing and democratic nature of local political institutions.

The new Executive Director of the Control Board will be Mr. Donald Kummerfeld, who is presently the First Deputy Mayor of New York, and who will bring to the Control Board his detailed knowledge and broad skills in City finances.

So it is appropriate that you sit here today where so many important and difficult decisions have been made, necessary but often painful decisions affecting the daily lives of millions of our citizens.

New York City is more than ever a vital and exciting City in which to live and work, but our City has persistent high unemployment -- especially among minority youth -- and a very large welfare caseload.
New York State is a national leader in the effort to contain welfare and Medicaid costs. These are heavy burdens for our taxpayers. We had hoped for major fiscal relief this year in the form of federal assumption of the local costs of welfare, but we did not get it. We are grateful for the immediate fiscal relief obtained for New York by Senator Moynihan, but as I have said many times before -- and I believe I am joined in this by State and local officials all across the land -- we must have the major relief promised by a complete federal takeover of welfare costs.

Our City continues to lose businesses, jobs, and people in what can only be described as an economic erosion of our tax base and the health of our City.

Our State, suffering from a ballooning debt caused by years of fiscal sleight-of-hand and outrageous mismanagement, and suffering from the highest level of individual and business taxation in the Nation, has not recovered as fast as other States from the severe national recession of 1974-75.

With that in mind, Mr. Chairman, let me tell the Committee briefly what the State of New York has done for the City of New York since January 1975. In 1975, before the Federal Government established the seasonal loan program, the State -- at great peril and cost to its own credit standing -- stepped in and advanced the City $750 million in aid.

In addition, the State created a rolling $800 million state advance which has been continued in each succeeding fiscal year. Since 1975, the State has used its access to credit markets to provide about $3.3 billion of advance financing to the City. These emergency efforts to assist the City with its financing were costly to the State and its taxpayers in the short run because of increased interest costs of the State's own borrowings.

But we realized that in the longer run, the collapse of the City of New York would have been a major economic disaster for the State, the Nation, and our leadership in the international economy. And today, as we witness New York City on the way back to recovery, we know we did the right thing. And the Congress did the right thing when it established the Federal Seasonal Loan Program for New York City.

The citizens of New York State -- as I have learned in recent visits to cities all over the State -- have renewed confidence in their State and in themselves, because they have learned that the State of New York will meet its obligations.
With the help of State Comptroller Arthur Levitt, the credit of the State not only survived but has been strengthened by renewed confidence in the State's finances, and the assurance that the State would not allow its localities to default on their obligations.

We now have a balanced State budget, and our latest state borrowings reflect an interest rate of about 2.5 points lower than it was at the height of the City's crisis.

This year, the State is assuming 75% of the operating cost of the senior colleges of the City University of New York, saving the City about $54 million.

Through the State's Tuition Assistance Program for Needy Students, we will contribute $45 million in tuition payments to CUNY - about one-third of CUNY's total tuition.

We will assume 50% of some operating costs of courts in New York City, amounting to about $28 million.

This year, the City will receive $19 million more than last year under the State aid formula for elementary and secondary education.

The State will share 50% of the impact on City revenues of the phase-out of the stock transfer tax, which will eventually amount to about $120 million.
In each State Fiscal Year since 1975-76, the State has given additional aid to the City, even while the State was containing the growth of its own budget.

Since I became Governor in 1975, I have kept the growth of the State budget below 4%, below the level of inflation, in order to restore the fiscal credibility of the State.

The size of the State budget has increased by only three or four hundred million dollars each year since I became Governor, yet in each fiscal year, we have increased our aid to the City by about $200 million. The State has not hesitated to share its limited revenue growth with the City.

In State Fiscal Year 1973-74, State aid to New York City amounted to about $2.4 billion. We estimate that at the close of this current fiscal year in March 1978, State aid to the City will be about $3.15 billion, an increase of 34% during a time of fiscal difficulty for all the people of the State.

New York State has done its part for New York City, and we will continue to do our part.

But the State has limits on its ability to help. The Budget of the City is larger than the budget of the State, and our State taxpayers have suffered for years from heavy taxation that has done nothing but damage the competitive ability of New York to keep and attract business and jobs.

But this year, New Yorkers enjoyed the first permanent income tax cut in 57 years, and I anticipate being able to propose further tax cuts for individuals and businesses in 1978.

The tax cuts I intend to propose to the State Legislature in Albany are absolutely essential to the economy of New York State and New York City.

We have no alternative but to lower our taxes with what flexibility we have.

Even with tax cuts in 1978, our taxes will be too high.

At this point in our recent economic history, the best thing we can now do for the City is rebuild the State's economy, which is dependent on a strong and competitive New York City.

The limited flexibility we have is best understood in the monthly report just issued to the underwriters of the 1977 State Tax and Revenue Anticipation Notes by Comptroller Levitt and State Budget Director Philip Tola.

They report that for November, the State has a $76.9 million positive cash flow, and that we currently anticipate an $18 million surplus at the end of our fiscal year in March. Every nickel of the surplus will be reported to the public in my Budget Message for 1978.

The businesses and citizens of our State have suffered high taxation long enough.

It is imperative that we now be able to return to them a dividend in the form of tax cuts.

Serious cuts in the taxes levied by the State will go a long way to restoring New York to the competitive position it once enjoyed among states.

Lower State taxes will be an invitation to businesses to remain in New York City and State, to locate or relocate in New York, to provide the jobs we need so badly.

Lower State taxes will be a further signal to all the citizens of New York, that the State government will continue to meet its obligations to them as individuals, as we have to the localities in which they live.
But even lower taxes are only a partial solution to the economic needs of our State, and will do no more than move the patient from the intensive care unit to the critical care unit.

What is most needed -- apart from strong Federal initiatives in manpower policy, welfare reform, and urban reconstruction -- is a permanent solution for the fiscal recovery of New York City.

I know, with the new leadership promised by Mayor-elect Ed Koch, and with the intensive efforts he plans for the City, that the City of New York will make every effort to create the necessary fiscal plan for economic restoration.

But I want to add a cautionary note here, from my testimony before this Committee in October 1975.

I said,

"The sacrifices the citizens of New York must make must be viewed in light of an important point brought out by a recent study issued by the Congressional Budget Office.

That report, requested by the Chairman and members of this Committee, show that the citizens of New York, contrary to most public opinion, do not enjoy a level of services for above the citizens of other cities."

The report stated:

"Yet, this is a misleading conclusion which stems from the fact that New York City provides services that in other areas may be supplied by a county government, a school district, or another specialized government. If one compares New York employment and spending patterns with those of all the local governments providing services to the residents of other large cities, New York appears to be less extraordinary."

The point made by the Congressional Budget Office in 1975, is even more valid today. Demands on New York for further sacrifices must be critically considered in the light of our pressing need for help.

But we are not here to ask for handouts. We have never asked for handouts. New York City has repaid promptly and with interest the loans it received under the Federal Seasonal Loan Program.

What we are asking for is a joint Federal-State-City fiscal compact that will provide the guaranteed and predictable long-term financing the City needs in order to set clear priorities, and in order to rebuild its economic infrastructure.

In order to build a house, you need a mortgage, not a finance company short-term, bill-payor loan.

In my view, the most efficient mechanism for the long-term refinancing of New York City would be some sort of federally guaranteed expansion of the borrowing powers of the Municipal Assistance Corporation.

That is what we asked for three years ago, and I feel compelled to say that we would be better off today had some version of this long-term assistance been worked out.

Such a long-term guarantee would have no impact on the Federal budget, and would enable the City to end its direct dependency on the Federal seasonal loans.

If a Federal-State-City fiscal compact were achieved, then the seasonal loan program could be scaled-down and phased-out over a relatively short period of time.

Federal participation in a long-term financial program for the City will enable the City to begin to market its own short-term notes in modest amounts, beginning perhaps in the summer of 1978.
Once the City can begin to make capital investments -- begin to borrow again -- the work of rebuilding the City can proceed at an accelerated pace made necessary by the age and heavy use of the City's physical plant, such as the century-old water mains in some parts of Manhattan and Brooklyn, our bridges, docks, and roads.

And once the City can reenter the financial markets, it can begin to restructure its own debt, and begin to relieve its taxpayers of the crushing load of debt service, which does nothing but drive up real estate taxes, which in turn drives businesses and jobs out of the City.

There are 18 million people in New York State, and we have come a long way since the difficult days of 1975, when the City and State were threatened with terrible uncertainties.

We have done much for ourselves, and we have had timely help from the Federal government. Now we need to find a permanent solution for the City's financial needs, a solution agreeable to all parties -- Federal, State, local and private.

Perhaps to find that solution, all we need do is go back three years to the original legislation that your Committee reported out, a bill that would have provided both short-term and long-term assistance to the City.

Perhaps we should begin at the beginning.
Chairman Moorehead. Thank you, Governor.
The subcommittee would now like to hear from the gentleman to whom the people of New York City and the people of New York State and, yes, the people of the United States, owe a great debt of gratitude for the able service he has rendered, Mr. Felix Rohatyn, the chairman of the Municipal Assistance Corp.

STATEMENT OF FELIX G. ROHATYN, CHAIRMAN, MUNICIPAL ASSISTANCE CORP.

Mr. Rohatyn. Thank you, Mr. Chairman.
Mr. Chairman and members of the subcommittee, Governor Carey has asked me to comment on the City's current financing situation, as well as on the prospect for future financing.

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

Insofar as MAC is concerned, we have had an exciting and, by and large, a most successful year. We have completed the various financings relating to $1 billion of publicly held City notes affected by the moratorium decision. We have also completed arrangements with the banks and unions which held the remaining $800 million of outstanding City notes. These notes were exchanged for MAC bonds as part of a complex $2.5 billion MAC refinancing and restructuring which enormously strengthened the MAC and leveled out its debt service.

As a result of these transactions, the City's budget was relieved by approximately $1 billion over the next 6 years; MAC's bonds were given investment grade ratings by the main rating services; our total outstanding bonds increased to over $5.1 billion with an average maturity of about 14 years and interest rates of about 8 percent.

We started the year financing at rates over 10 percent, continued with an exchange offer of $400 million at 9 3/4 percent, and ended with two public offerings aggregating $400 million at 7 1/2 percent.

As a result, we have the economic horsepower, within the MAC's ratios and bond covenants, to raise another $2.5 to $3 billion on the City's behalf.

Doing so, however, will require affirmative action on the part of the State legislature, lifting our statutory debt ceiling from its present $5.8 billion to $8.8 billion and giving us a broader charter with respect to capital financing. It will also presuppose continued market access for MAC, in size and on reasonable terms.

We have fought our way back from very far to have MAC accepted in the marketplace and our credit rating restored. However, the interest rates we are currently required to pay, 7 1/2 to 8 percent, are still penalty rates when looking at other tax-free municipal issuers with investment-grade ratings.

These rates reflect the huge volume of MAC, anticipated future offerings, and continued nervousness with respect to New York. It must be remembered that in addition to being required to provide for most, if not all, of the City's capital financing for the foreseeable future, MAC should and will refinance some of its early high-interest,
short-maturity issues. We expect to proceed shortly on the initial
stages of such a program, which in the aggregate could amount to as
much as $750 million over a period of time.

The issue of market access is a critical issue for us, maybe the critical
issue, and I will revert to it. Bear in mind that MAC was originally
created to refinance $3 billion of City short-term debt; we have now
refinanced $5.5 billion and expect to make the same revenue stream
support close to $9 billion. There is a limit to everything, even to MAC.

Insofar as City financing is concerned, the picture is quite different.
As you know, an initial City note sale, scheduled for November, in the
amount of $200 million, collapsed as a result of an unsatisfactory credit
rating and the inability of the underwriting group to commit to the
sale.

This occurred even though there was little question as to the actual
security of the notes. The unwillingness of the market to absorb City
paper of reasonable security, short maturity, and very moderate size
bodes ill for the City's ability to finance not only short term but long
term as well.

It was clear from the Moody's rating of the City notes that a variety
of uncertainties still surrounding the City would continue to affect
its ability to sell securities. The main items are, in no particular order
of importance:

1. The ability of the City to have a recurrent, credibly balanced
budget;
2. A more rapid phasing out of expense items from the capital budget to
create true balance;
3. The failure of the State legislature to increase the MAC borrowing
authority, leaving the union pension systems as the sole current source
of capital financing;
4. The absence of an agreed-upon Federal financing role post-June 30,
1978;
5. The labor negotiations set for the spring of 1978;
6. And the absence of an agreed-upon long-term fiscal monitor, a sine
qua non for long-term City financing.

In order to briefly sketch another weakness in our financial struc-
ture, carried over from the past, you will remember that New York
has two types of outstanding long-term debt: MAC and City bonds.

There are outstanding about $5.5 billion of bonds in each category.
The peak debt service requirements for MAC are under $800 million
in any one year. On the other hand, present debt service for City bonds
is about $1.3 billion annually, reflecting appalling debt management
practices in the past and resulting in property tax levels at prohibi-
tively high rates. This latter problem needs to be dealt with.

It was my judgment last year that the City should be able to market
moderate amounts of short-term notes this winter, followed by modest
amounts of long-term bonds in the spring of 1978.

I also felt that an accelerated phasing out of expense items from
the capital budget was important but not crucial to long-term financing
and had to be balanced against the damage to the City's economy of
further service reductions caused by such an accelerated phasing out. Fi-
nally, that the issue of the long-term fiscal monitor was resolvable
allowing for a return to a minimal level of political sanity following
the mayoral election.
It is obvious that I erred on the side of optimism on every one of these issues, even though optimism with respect to City matters has not been my dominant trait.

Even though the City note sale, from a pure credit point of view, should have taken place, its failure means that, at the earliest, the City will do short-term seasonal financing in the summer of 1978. Prior conditions thereto will be the satisfactory conclusion to labor negotiations this spring, a credibly balanced budget for 1978-79, a Federal financing program post-June 1978.

Sporadie discussions with respect to a long-term monitor have taken place over the last few months among banks and unions, City and MAC with limited areas of agreement. Until the new City administration can grapple with this issue, along with many others, little further progress will be made.

Even assuming for the moment agreement on a long-term monitor, I believe the failure of the City note sale reflects a market whose skepticism with respect to any kind of City paper is extreme. One reason for that skepticism is the growing awareness that while the City's budget now complies with law, the law permits the continuation of practices which keep the budget from being truly balanced. For purposes of planning, therefore, I have to assume that, until all expenses are phased out of the capital budget, the sale of significant amounts of long-term City bonds will be difficult if not impossible.

This brings us to the issue of the City's budget for fiscal 1979 and beyond. MAC is beginning its review of the preliminary budget submitted by the City a few weeks ago. The deficit estimated by the City to be about $250 million has been estimated by others to be still higher, even before the impact of labor negotiations is factored in.

To close such a gap, in addition to doubling the phaseout rate of capital expenses, without unacceptable levels of service reductions, seems rather questionable.

If possible, the phaseout of capital expenses should be financed by new, presently unavailable revenues. One such source of revenue might be property taxes freed up by refinancing City bonds with short maturities and high levels of debt service. This will bring us back to the issue of market access in due course.

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

Our objectives, after about two decades of fiscal and financial insanity, are to bring New York City's budget back into true balance without destroying the City's social and economic structure, and to bring the City's financing needs into balance with its ability to sell securities.

The memorandum which MAC submitted to Governor Carey on this subject, and which is submitted to you herewith, estimates that to ac-
accomplish these objectives we require about $4.5 billion of long-term financing over the next 3 years, in addition to approximately $750 million of refinancing that MAC would undertake of its previously issued bonds. (The memorandum referred to may be found at the conclusion of Mr. Rohatyn’s statement.)

Completion of such a program would leave the City with a truly balanced budget and total financing requirements of about $1 billion seasonal and $1 billion long-term annually. These would be well within the capacity of the private market to absorb, under these circumstances.

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

I recognize that this is not the time to discuss post-1978 Federal financing programs which, I assume, will be the subject of later hearings.

However, I would like to leave you with these thoughts. It is as important to the lender as it is to the borrower to provide the appropriate amount and type of financing; both lender and borrower are tied to the same umbilical cord. A short-term loan that should have been long term will become long term because of the inability of the borrower to extricate himself in time and the recognition of the lender that extending the loan is, in the lender’s own interest, preferable to bankruptcy. Many credits by U.S. banks to underdeveloped countries have gone through the process. On the other hand, the appropriate long-term loan, which gives the borrower breathing room to put his house in order, can turn out to be a much shorter investment by permitting the lender to sell his bonds in the market once market conditions have stabilized.

The New York situation is, in my judgment, more of a market access problem due to unique volume requirements than a pure credit problem. The moratorium of 1975 was imposed because of our inability to convince the then administration that acquiring $1.7 billion in long-term MAC bonds, as part of a financing package, was preferable to legislating a moratorium on an equivalent amount of City notes.

The market then would not absorb the MAC bonds. Had we prevailed, such MAC bonds, bought by the Treasury, would long since have been resold, probably at a profit, and the State would have avoided a legislative act which will haunt it for decades. That is but one example of a situation where long-term market assistance was appropriate and would have been in both the lender’s as well as the borrower’s best interest. It was not forthcoming because of theological, not economical, reasoning.

In closing, let me suggest that New York’s economic health still has to be the foundation on which any financing will stand. New York must turn its economy around through a better business climate, tax cuts, better schools, safer streets. New York, however, cannot be expected to prosper within the framework of a national economy running $60 billion deficits, 7-percent unemployment, a devaluing dollar, $43 billion of oil imports.
One out of eight people in the City are on welfare and nothing has happened to provide the kind of fiscal relief we had been led to expect; we cannot continue to bear that burden. We have cut services and raised taxes; we can do more, maybe, but soon our cuts will not keep up with the velocity of the shrinkage of our tax base.

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

Chairman Moonhead, Thank you, Mr. Rohatyn. And without objection, the memorandum attached to your testimony will be made part of the record.

[The memorandum referred to follows:]
21 November 1977

TO:  Governor Hugh L. Carey

SUBJECT:  New York City Financing - Federal Role

The failure of the sale of city notes brings to the forefront again the question of City market access, both long and short term, as well as the appropriate Federal role after June 30, 1978 in providing financial assistance to the City.

It is our judgment that the City will be able to market short-term notes, in modest amounts, beginning in the summer of 1978, provided that:

a) Satisfactory agreements are negotiated between the City and its unions in the spring of 1978, and the investments by the Pension Systems called for in fiscal 1978 are completed.

b) A credibly balanced City budget is presented for fiscal 1979.

c) A federal financing role after June 1978 has been defined and implemented.

Much more serious questions are raised with respect to City access to the long-term markets. It would be imprudent to think this could take place before greater credibility exists in the City's ability to balance its budget, combined with an acceleration of the phase-out of expense items from the City's capital budget, and increased confidence in the City's economy.
There is no vehicle available, at present, to provide long-term financing to the City on reasonable terms beyond June 30, 1978.

The Municipal Assistance Corporation, following the Restructuring Agreement, has the economic capacity under its existing bond resolutions to raise another $2.5-3 billion over the next several years, provided the Legislature concurs and assuming favorable markets. While this economic capacity should be included in any long-term financing program for the City, we will indicate below that the City's needs for long-term financing are greater than the amount MAC can provide.

Another potential source of funds is the City's Pension Systems, whose present commitment to purchase City bonds expires on June 30, 1978. While it is possible that the Pension Systems might be persuaded to participate to some extent in the exchange of City bonds for MAC bonds which is an integral part of our financing program, we believe it unwise to count on the Pension Systems for new investments after June 30, 1978, since spokesmen for the Pension Systems have indicated their desire to scale down the 37% or so of their assets tied up in City and MAC obligations.

This should therefore, once more, lead to an examination of a Federal role in the long-term financing area. As you know, the Municipal Assistance Corporation has long held the view that such a role was not only necessary to the City, but also beneficial to the State and the Federal Government, as well. It may be difficult to persuade the Federal Government to accept these conclusions. However, we will continue our practice of giving you recommendations on the substance of the financing problem while recognizing that political realities may ultimately preclude their implementation.

Simple extension of the existing Federal Seasonal Loan Program would be the mere application of a band-aid to a continually bleeding wound. It is a bridge to nowhere. However, Federal long-term financing assistance would enable us to complete a series of actions which would make the City financially viable and capable of undertaking more vigorous action for its economic recovery.

The three-year plan recently evolved by Comptroller Goldin, consistent with the actions previously taken by the Municipal Assistance Corporation, contemplated the following:
a) Refinancing on a long-term basis the current rolling $800 million annual Spring advance from the State to the City. This advance is in reality a residue of past City deficits.

b) Phasing out the expense items currently carried as capital items over three years instead of the remaining eight years allowed under existing State law.

c) Extending the Federal Seasonal Loan on a scaled-down basis.

d) Using the Municipal Assistance Corporation to do most of the City's capital financing for the next three years, coupled with moderate amounts of new City bond sales as well as reinvestment by the Pension Systems.

e) Amending the Municipal Assistance Corporation legislation to expand MAC's responsibilities as a long-term fiscal monitor.

Several aspects of this plan are highly desirable, including the bonding out of the State advance and the accelerated phase out of expense items in the capital budget.

In addition, as part of the accelerated phase out of expense items, we believe the Municipal Assistance Corporation should refinance, on a long-term basis, some City bonds coming due in the next few years to permit the City both to lower its property tax rate and to provide budgetary relief. We estimate a need for refunding of some $600-800 million of such City bonds through the Municipal Assistance Corporation.

We, therefore, see the following aggregate needs for long-term financing over the next three years:

- $1,000-1,150 million for capital (including expenses)
- 600-800 million for restructuring City bonds
- 750-800 million for bonding out state advance

These needs should total approximately $4,500 million over the next three years.
We do not include in this total some $750 million of possible refinancing of MAC's early, high-interest, short average life issues, which could provide another $50 million or so of budgetary relief, but which would not count against our borrowing authority.

You can see from the above that the City's real needs are for 50% more than the amount which MAC is permitted to finance under its existing bond resolutions.

The prudent thing to do, in our judgment, would be to provide for the City's needs of $4,500 million, half by public sales of MAC bonds under the existing First and Second Bond Resolutions and half by a sale of MAC bonds to the Federal Government under a new (Third) MAC Bond Resolution.

The rights of the holders of MAC's bonds issued under its First and Second Bond Resolutions would not be affected by issuance of Third Resolution bonds, which would be backed by city bonds held by MAC rather than by MAC's traditional revenue sources.

The purpose of the financings could be broken down roughly as follows:

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<th>Amount</th>
<th>Description</th>
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<tr>
<td>$800 million</td>
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<td>$350 million</td>
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<td>$2,250 million</td>
<td>Capital Construction</td>
</tr>
<tr>
<td>$4,500 million</td>
<td>Total</td>
</tr>
</tbody>
</table>

The proceeds of MAC's sales to the Federal Government could be allocated to either half of this program, with public sales financing the other half. However, for present purposes, we are assuming the Federal loans will be used for the capital program.

The MAC issue sold to the Treasury would be a Third Resolution MAC, say of 25-year maturity, at the Treasury's interest cost plus say 1/4%, secured solely by a long-term City bond of similar terms and conditions. An additional component would be the creation of a long-term fiscal monitor of the City, which has been contemplated as a prerequisite to a public sale of City bonds, and which would also benefit the
Treasury as holder of the new MAC bonds. By securing such a MAC Third Resolution issue solely with a City bond, we would not impinge on the coverage of our First and Second Resolution bonds. The $2,250 million of public MAC financings consisting of First and Second Resolution bonds would leave MAC with $750 million of reserve borrowing power with which to handle other contingencies.

Assuming, as did the Goldin plan, a scaling-down of the Seasonal Loan, the Federal Loan program might consist of the following (in millions):

<table>
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<th>Year 4</th>
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</tr>
<tr>
<td>Long-term (aggregate issued)</td>
<td>500</td>
<td>1,250</td>
<td>2,000</td>
<td>2,250</td>
</tr>
<tr>
<td>Total</td>
<td>$2,250</td>
<td>$2,250</td>
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The City's current seasonal requirement is roughly $2.0 billion. Assuming a gradual bonding out of the State advance and a smoothing of funding for the capital budget, total seasonal requirements should decline. After deducting the amount of Federal seasonal loans available in each year, the seasonal requirements to be raised by the City in the public markets would range from $250 million or so in the first year to approximately $1 billion in the third or fourth year.

These estimates may be conservative, and the City may actually exceed this schedule for reducing its need for Federal seasonal loans.

At the end of such a three-year program, the City's financing position would be:

a) Bonding out the State advance will finance long-term this element of the City's past deficit.

b) The City's total financing requirements will be $2 billion each year instead of its current $4 billion. Of this amount $1 billion will be seasonal and $1 billion capital.
c) Both the seasonal and capital financing requirements should be within the City's ability to meet in the public markets. MAC will still have some borrowing power left to supplement any shortfall.

d) With expense items out of its capital budget, the City's overall budget will be truly balanced and its capital expenditures will result in true physical improvement and accelerated economic activity.

e) The Treasury will have an investment of $2.25 billion in a marketable bond which it should be able to liquidate, without undue market pressure, over the following three to four years. It will have made a profit on the financing and there could be an agreement to adjust the rate to a market rate at the time the Treasury resells its bonds.

We have discussed this approach with Comptroller Goldin and agreed to instruct our staffs to prepare a detailed plan which we could jointly propose to the City and the State and which could be the basis for our approach to the Federal Government. Steve Clifford and Gene Keilin have already started on this work.

Felix G. Rohatyn
Chairman

Eugene J. Keilin
Executive Director
Chairman Moorhead, Governor Carey, I am intrigued by your statement about the concept of the City-State-Federal compact. I think this is a marketable idea, but I would like you to spell it out a little bit more.

For example, Mr. Rohatyn's memorandum suggests a long-term Federal loan. Would the idea of the City-State-Federal compact include New York participating—the State of New York participating with the Federal Government, say, for openers, on a 50-50 basis?

Governor Carey. Well, I wouldn't say 50-50, given the level of your resources and the level of our resources. But I do recollect that in our refinancing of housing mortgages in some of the limited-profit housing companies, we were able to deal in terms of a guarantee with the Federal Government and the State was required to take some of the equity or have a portion of the coverage for its own accounts.

In other words, in talking about the City-State-Federal compact theory, what I am suggesting is that as we prepare a plan—and I emphasize again that Secretary Blumenthal suggested that this plan be prepared as a matter of work among the Federal Government, the State, and the City—that we do have assigned responsibility and shares that we have to uphold. The mechanism that we talked about—that is, the monitoring mechanism—would have to be one agreeable to the Federal Government, and I would expect that the State in some form would participate.

MAC is a State agency. Additional powers of surveillance and monitoring given to MAC would be one way in which the system could work. But as to what the State could reasonably be expected to do, we would like to negotiate with the Federal Government as to what the State can properly be expected to do, given the fact that our whole system of budgeting in New York State is one where we make a statewide collection of income taxes, of sales taxes, of a whole variety of taxes, and then, in return, share those with the local governments.

We would expect a definite commitment of financing by the State to the City, of the court system, and certain other functions that are now carried on by the City would be part of that compact.

Chairman Moorhead. Mr. Rohatyn, as I understand the thrust of your testimony, you are saying that looking economically, not theologically, it makes good sense for America's taxpayers to have a long-term solution to New York's problems, rather than this temporary situation we have had, and that if we had a long-term solution we could actually get out of the short-term problem?

Mr. Rohatyn. Mr. Chairman, I am a financial adviser. That is my business. I get paid lots of money by lots of people, not by the City or the State of New York, but by lots of other people, which permits me to do this for the City and the State of New York. If I were your financial adviser, I would say to you that that is the best and cheapest and easiest way to get out of this situation.

Now, especially, if you go to the route of guarantees, for instance, where our bonds would become taxable, I could show you that the Federal Government would make probably 100 percent or 80 percent over the total principal amount that they would be guaranteeing out of taxes and guarantee fees.

Incidentally, this computation that the Federal Government only makes 80 million a year out of the seasonal loan doesn't include the
computation that the Federal Government collects taxes on their own financing, which normally would be done with tax-free financing by the City, and that the Federal Government has probably made $200 million out of the seasonal loan program and not $20 million.

I believe this very strongly. One of the reasons, actually, Mr. Chairman, was something in here about City Council pay raises, and so forth, I always refused, not just to take a salary, but to be reimbursed even a sandwich for what I do, is to be given the greatest luxury to appear here as a taxpayer, not as an official looking for favors, and feel that you all represent me as a taxpayer and that I can tell you what I think is in the best interest of this Government as a taxpayer. And I really believe that.

Chairman Moorman. Thank you. I think this subcommittee wants the best, cheapest, and quickest way to end this situation.

My time has expired. Mr. McKinney?

Mr. McKinney. Mr. Rohatyn, frankly I thought we had a good bill reported out by this committee, which was a long-term bill. I remember a hard night trying to iron out the famous 10 points. I would agree with the Governor. I would like to go back to the beginning and start all over again. I don’t think we would be in this mess. But we are there.

Two things interest me. One is, if we were to go to a guarantee program, how long should that guarantee last?

Mr. Rohatyn. Well, we should, ideally, Mr. McKinney, refinance maybe $2 to $2 1/2 billion on a really long-term basis. And I think we should refinance on a 20- to 25-year basis. Now, that doesn’t mean that either the guarantee has to stay on there for 25 years or that if the Federal Government were to invest in our bonds that they would hold them for that period of time.

I think you can structure all kinds of ways, not only to give the Federal Government every assurance that it presently has with the existence of the Control Board and the existence of a monitor, but also to structure into such a guarantee enormous incentives for the City to refinance that guarantee out and to get out from under. Because if we do have a guarantee we will have taxable bonds; we will have guarantee fees and the rates at which this financing will take place really should be such as to within 2, 3, 4, 5 years make it highly economical and desirable for the City to refinance its way out of it.

So, I think, technically, if you do go with a guarantee, you should go with a long-term guarantee but structured in such a way as to create economic incentives for the City to get out of it and to finance its way out of it much before that.

Mr. McKinney. I would be very much interested in the example, if you could ever get it for us in writing, about how you think this would work.

You suggested that you could prove in writing that it would settle it, and I think this subcommittee would like it for its deliberations.

Mr. Rohatyn. Yes, sir.

Mr. McKinney. On the last page of your testimony, you talked about something that disturbs me, and that is the velocity of the shrinking tax base. You read the figures of New York losing 490,000 people, losing 550,000 jobs, an unemployment rate of 10 percent compared to the national rate of 7.7.
How can the City possibly answer its financial problems of today and still have the stimulus it is going to need to get out of that type of shrinking situation?

Mr. Rohatyn. Well, I think that having a proper financing structure which gives people who set up businesses in the City a long-term view of stability, together with the Governor cutting taxes and the new mayor and the new deputy-mayor running the City efficiently and being able to undertake programs of economic development really have to go hand in hand. But I don't think they can do their job unless we have a stable financing structure on which to build it. And then it is just going to have to be—it is going to be long and difficult but I think it can be done, but only on that basis. You have to have a stable financial platform on which the Governor can cut taxes and from which the new mayor and the new administration can do their thing.

Mr. McKinney. Thank you.

Chairman Moorhead. Mr. Badillo.

Mr. Badillo. Thank you, Mr. Chairman.

As the Governor has indicated, this has been the room where we have worked over the past few years, and strangely enough, Ed Koch and I have been here representing the New York congressional delegation. So, I want to take this opportunity to praise Governor Carey and Mr. Rohatyn for the work that they have been doing and which we have been reporting back to the New York delegation over the years.

I think you know that this subcommittee has before it, at the same time that we have the question of the seasonal loans, the question of the establishment of a national development bank which is designed to help the areas of the country, including the urban areas, which have been depressed and have not recovered, as the State of New York has not recovered, from the recent recession.

Would you suggest for the long-term mechanism that a separate bill be prepared for the particular situation here, or would you include it in the national development bank idea?

Governor Carey. Mr. Badillo, I have heard of the development of the national urban bank, and we have had discussions on this matter with Mr. Altman, working with Secretary Blumenthal, and the time frame on that bill seems to be quite far distant, whereas I know and you know that the resolution of the uncertainty for the New York City problem will have to be worked out in the early months of 1978.

I would like to see the separate urban bank concept because, as I mentioned earlier, New York is not unique; there are other localities that have difficulty, and there are imaginative ideas that can be worked into that kind of a bank system.

I have noticed, for instance, that a local borrowing in Nassau County was brought down several points because they were able to take advantage of municipal insurance on the borrowing that they were undertaking, and it made it a more attractive issue. And that kind of an organized insurance program, working in combination with the national urban bank much in the way the Federal Deposit Insurance Corporation works with thrift institutions and other banks, could well be the wave of the future for the offering of municipal borrowings.
Then, we would be away from this rating system which, as Mr. Rohatyn has indicated, just trapped this City at a time when a $200 million offering was not worthy of it. It was a good offering, but all we had to depend upon was the rating system and the condition of the market, and therefore, the City could not take that step.

Mr. BADILLO. Thank you.
Chairman MONAHAN, Mr. VENTO.
Mr. VENTO. Thank you, Mr. Chairman.
Governor Carey, we spoke of long-term financing as opposed to the seasonal issuance of bonds, incurred before I began serving in Congress. How do you see that functioning? Do you see any different types of controls that might be necessary, as opposed to the seasonal issuance of bonds, or do you see it pretty much functioning the same way in terms of some of the financial decisions that are made for New York City—and I think that is fundamental. I don’t know if we have to articulate each one of them today, but I would like to get your impression, at least in a general way, of how you think that might function differently than the seasonal issuance of bonds has functioned.

Governor CAREY. We have had the attendance of a Treasury representative at some of our meetings, and the Treasury has secured the services of Arthur Anderson to do surveillance on some of the accounting and other reports that have been issued by the City. But for the Board, in order to handle some of the flexible ideas that Mr. Rohatyn has been talking about in the handling of the longer-term issues, a designated person in the Federal Government might well be part of the mechanism that is set up to run the length of the loan or the length of the commitment.

Mr. VENTO. Let me rephrase what I am trying to get at.

How do you see the structure of decision-making and the establishment of parameters for the disqualification of certain types of expenditures has worked? I fear that as a Member of Congress that we have been concerned with long-term financing, and, you know, you don’t have the same kind of continuity that you might have during the short term.

How is your system working currently?

Governor CAREY. Let me answer quickly, and I then think you would benefit from someone else’s view—Mr. Rohatyn, who has served as an observer of MAC in this whole Control Board process. As chairman, I have been part of the Board, and therefore, I will confine my estimate and analysis to this.

The Board’s function was to take the financial plan submitted by the City and determine that the revenues and expenditures were in balance according to the City’s record. And then anything the City wanted to do within that, in terms of its own local self-government, was permissible.

That is what has been going on, and the power of intervention or the reversal of decisions of the kinds of things like the pay raises and things of that kind did not rest with the Board as long as the financial plan submitted by the City showed that on the basis of its records its expenditures and revenues were in balance. That is what we have had.

Now, in terms of what you contemplate, Mr. Rohatyn, perhaps, would look at this differently from this system that has been in place before.
Mr. Rohatyn. I would just comment—the system that you have in
place today is a system where your weapon, if you will—the weapon
of the Congress and the Federal Government—is not to make the loan
every year. It is the bluntest kind of weapon. It is the weapon of bank-
ruptcy, and because it is the weapon of bankruptcy, it is really not an
acceptable weapon, in my judgment, because it will hurt the banks all
over this country, it will hurt the national economy, it will hurt the
State. It is really not a weapon—in any kind of long-term financing
structure that we have, whether we negotiate it with the Federal Gov-
ernment, whether we negotiate it simply with the public, we have to
have a long-term monitor that will be much more of a surgical tool
than the kind of blunt instrument that you have today. And it will be
a surgical tool that will almost regulate itself and try to help the new
mayor and the new administration, and mayors for the next 20 years,
to withstand the pressures that keep occurring here and keep pushing
this budget out of balance.

So, again, I think you have a situation here that is very difficult to
negotiate. A sort of middle eastern settlement, in an open conference—
this is really what you are going to have. If there is a solution here, you
have to have the Secretary of the Treasury, the mayor of the City, the
Governor of the State, the MAC, the unions, the banks—all negotiati-
ing their various contributions to such a package.

Obviously, I would not suggest for a second that you simply give us
a long-term loan and you walk away and we walk away and the State,
the City, the banks, the unions have not done anything.

On the other hand, a lot has been done. I think more can be done,
but I don't think it is doable without Federal participation at the ne-
gotiating table and in the financing for some time to come. But once
we get into the negotiations, believe me, technically we can satisfy
you.

Mr. Venuto. My time has elapsed, although I don't feel much en-
lightened at this point. I realize this is going to be a subject of nego-
tiation and it is tough, but I was just interested in how you felt it
would work.

Thank you, Mr. Chairman.
Chairman Moorhead, Mr. Stanton.
Mr. Stanton. Thank you, Mr. Chairman.

Mr. Rohatyn, we have read a lot about New York, and I just want
to tell you that I have just read your excellent statement, and I think
you are right about what you say.
I guess you really don't have to repeat the problems that we have
had, and I happened to be on the majority side of that. I wonder, how-
ever, where is this responsibility of the Federal Government to which
you refer?

Not to go back 2 years, but it wasn't philosophically right at that
time, and it probably isn't, today, to ask the American people to go
through with the original plan that we had discussed in the Congress.

Now, there is no denying that what we did come up with, though,
was this cash seasonal adjustment program. That is all we got, really.
New York said they would pay, and they have kept every commit-
ment that they made. The only thing that bothers me, though, is that
when we went through the seasonal adjustment program—it was the
only thing, really, we could get that we could get a majority of people
to agree on that we felt philosophically that we could do to help the
city.

The administration and the Governor and you and I and Bill Si-
mon, we all agreed that this could do it.

Now, I was, first of all, quite surprised that the President in his
message to Congress asked the City and the MAC and the State to do
about 15 different things, and I had presumed that I would be smart
and ask our staff to check into those things, and we found quite a few
of these things weren't done. But I will tell you truthfully that I was
pleasantly surprised to find that overwhelmingly every agreement be-
tween the City and the State and MAC, to qualify it for the seasonal
adjustment loan, you have kept; you have done it.

But also, going in, we all felt and you felt that this was enough to
get us over this hurdle. At least, we thought that—you are shaking
your head. Maybe I am wrong on that, but I ask you today, as you
look back and as you look for a continuation of a different approach—
and we haven't talked about that in the broader terms—my question
is: Having kept all the agreements that we made and you made, what
could have been done differently in the last 2 years, or what can be
done differently in the next 6 months to return to that optimism that
we all felt in early December of 1975?

Mr. ROTHAYN. Well, Mr. Stanton, the reason I was shaking my head
was, I, as you may or may not remember, have been doing everything
but setting myself on fire to get some long-term financing into this
situation from day 1.

Now, the commitments that we made or negotiated with the admin-
istration, they were to transfer $100 million of pension funding from
the City to the unions. That was done. To raise taxes—that was done.
To get the pension systems to put up $215 billion to finance the next 3
years—that was done. To get the banks and the unions to lower in-
terest rates and extend maturities—that was done. And to put the
moratorium in, which was no pleasant thing to do—and that was done.
And then to refinance the moratorium without any help from anybody
else, which amounted to $1.7 billion—and that was done.

Now, I have a deal with the Governor, which is that I don't worry
about politics. He worries about politics, and I worry about sub-
stance—on financing. And I am perfectly aware of the fact that it may
not be politically doable to do anything other than to extend the sea-
sonal loan, but I owe it to you to tell you that just as 3 years ago I did
not think this would solve the problem, I don't think it will solve the
problem today. But we will still repay the loans. We will still keep
our commitments, and 3 years from now you'll be faced with the same
choice again—only at that time the City will be in a more difficult con-
dition economically.

Now, if it can't be done any other way, obviously it is better than
bankruptcy, because maybe somehow there will be some divine inspi-
ration at the end of this tunnel. But otherwise, I have to tell it to you
the way I see it.

Mr. STANTON. Thank you.

Chairman MOOREHEAD. Mr. Hubbard.

Mr. Hubbard. Thank you, Mr. Chairman.
And again, from each of us to the Governor and to Mr. Robatyn, we appreciate your testimony. I have listened with interest to your comments regarding the solutions to the New York City financial dilemma.

In Kentucky we have schools that we are proud of, and I would love to show Congressman Bruce Caputo, my colleague, some of our schools that we finance through property taxes. We have money available for our farmers, policemen and schoolteachers, and so forth, through property taxes.

The Kentucky Supreme Court has ruled that taxes on property shall be 100 percent of their fair market value. Through the kindness of the Associated Press and the United Press International, we have been reading down in western Kentucky that you don't have—or that you do have rent controls here in New York City which we don't have in Kentucky. And I am sure people in Clinton and Smithton, Ky., who pay their Federal taxes and know that New York wants some of that tax money, would like me to ask today why it is that the State legislature of New York next month doesn't lift this law or ban this law that allows New York City to have rent controls.

I understand that a prominent elected official in New York City lives in a $250-a-month apartment in Greenwich Village. The landlord says there is a problem with rent, that it would be $400 to $450 a month without such rent control.

And I know of a native Kentuckian who lives on Central Park West whose rent is $600, and he has admitted that he would pay twice that amount if they did not have rent control in New York City.

Again, as a Kentuckian, where we have a property tax and where we pay our bills and keep solvent through property taxes, what about the chances of the State legislature in Albany next January and February and March, doing its share, as you look to Washington for us to do our share? How about legislation to lift rent controls in the City of New York?

And I would ask if the Governor and Mr. Robatyn could address themselves to that situation, which we, in Kentucky, deem shocking—that you all have rent controls here in New York City and yet you tell us in Kentucky that you need Federal participation and long-term financing.

Governor Carey. Let me say how pleased I am to hear that western Kentucky is doing so well and that Gov. Julian Carroll has a good administration there. I harken back to the days when I served under Chairman Carl Perkins of Kentucky on the Education and Labor Committee—Mr. Badillo might recall this—that whenever we had to work up a formula for Federal aid to education, we made certain that a healthy share of that went to the poor districts of Kentucky. I am glad to hear that things are working out so well.

Mr. Hubbard. We did have to raise our property taxes, though, in part.

Governor Carey. You have coal and a rural economy, and the property taxes on Kentucky land, I don't think, approach what we pay in terms of property taxation in New York State and its counties and cities to support our schools.

Mr. Hubbard. What about New York City, though?
Governor Carey. The City currently has the whole matter of assessment in real property for New York City under both judicial and legislative study, to see how we can redress certain inequities in the property taxing system of New York City.

But as for rent control, you are in an ideal spot to observe why there is a rent stabilization system still in effect in parts of New York City. All of the dwellings of New York City are not under rent control. A limited number remain under rent control. Why is it there? Because on any finding, any analysis, you will find there are insufficient dwellings available for persons of limited means to supply them with shelter in New York City. How can we get more? Right outside this building, a beach was created with some federal funds for engineering and with a change in the Federal bulkhead line, and it says, “Battery Park City.” There is 100 acres. That could well supply some housing, and there are many other sites around the City that could supply housing stock.

We can’t seem to break through the kind of arrangement we need to supply the credit and the construction costs per room that people can afford. That is why we have a contained rent system for those who can’t afford to pay any higher rents, because we have not renewed nor have we been able to modernize or rehabilitate the housing stock of New York City for lack of funds.

One of the things that got this City in trouble was that, in order to try to maintain some rent structure, they used short-term borrowings to try and stabilize the cost of maintenance, fuel, and power and so forth in housing.

Mr. Hubbard. Well, haven’t rent controls discouraged the construction of new housing units in New York City?

Governor Carey. To a degree, yes. There is building going on. In fact, we have a shortage of space now for commercial rentals, and there is a heavy market and a very profitable market in luxury and upper-income housing. And that is being constructed to a degree. But we have a major poor population in the City, a major poor population that would like to go to work and be employed in rehabilitating some of the housing stock that has been lost to the City, and would dearly love to be working on the creation of new housing.

The credit arrangement now in place, on the estimate of any expert in the field, is such that it does not pay to invest in New York City housing, unless there is some form of subsidy because of the cost of fuel, construction, maintenance, and financing. And that is why we have rent stabilization.

There is a commission that has been constituted by the legislature to study the matter of rent stabilization, to see how in certain cases, if the tenant could afford a modest increase, say 7 percent a year—and that is not so modest when you think about it—but say 7 percent a year, there could be some stabilization, and based upon the ability to pay, some relaxation in some of the units now in stabilization.

Mr. Hubbard. Thank you.

Chairman Moorhead. Mr. Kelly.

Mr. Kelly. Thank you, Mr. Chairman.

Governor, as I understand it, New York has really done a good job under your leadership, and you feel now that the Federal Govern-
ment needs to come and give you some kind of financial relief, in
order to go forward.

Governor Carey. I would just say that if we approach this as a mat-
ner of the best kind——

Mr. Kelly. Could I just get an answer to that question generally:
Governor Carey. I don't like the word “relief.”

Mr. Kelly. All right, fine, I will strike that, but you feel as though
under your leadership New York has done what it could and should
do to solve its own problems.

Governor Carey. The State of New York, yes.

Mr. Kelly. What about the City of New York?

Governor Carey. It has done as well as it could reasonably be ex-
pected to, given the heavy debt that was on its shoulders. It has had
to refinance, as you heard the refinancing that has been done in this
2½ year period.

Mr. Kelly. Well then let me ask you this: Why is it that New York
pays the highest wages in the United States of America to its employ-
ees when you consider the fringe benefits, and even if you don't con-
sider it, they are extremely high wages? Why are you paying the
highest welfare benefits? And why do you have the rent control that
was referred to? Isn't it just clearly a fact that the political leadership
in this State and in this town lack the courage to face up to these prob-
lems? They lack the courage to face the labor unions, and to cause
them to live within their means, and that you lack the courage to face
the people that are on welfare that are being paid the highest levels in
the country, and that you lack the courage to face the renters here in
your town and cause them to pay their own way, and you are perfectly
willing to continue a proposition where already $20 billion have been
taken from property owners, private property owners, right here in
this City and given to the renters to the extent that you have destroyed
or seriously damaged the ability of this State to go forward because
private capital is fleeing. Your tax base is being diminished, and the
job level in the private sector in New York City has diminished, and
all of this because politicians just won't face up to the realities of these
three areas.

And there are more. But just in these three areas, why should New
York pay the highest wages, including fringe benefits, in the United
States of America? And then send the bill to everyone else? It is just
a question of political guts, isn't it?

Governor Carey. I objected to the term “relief,” and now you want
to talk about “courage” and “guts.” If you don't have the courage to
stick it out in New York nor the stamina to put up with what we have
had to put up with, you have an alternative: you take your retirement
benefits under these fringes you speak of that are so delectable, and
you pick up and you get yourself a ticket and you go to Florida and
you live there. That is one of the things you can do with your retire-
ment benefits. People don't stay in New York with their retirement
benefits, and I know they are enjoying your climate with their retire-
ment benefits.

Mr. Kelly. Well, I can think of more reasons than that for getting
out of New York.
Governor Carey. You know, as soon as you start to partake on the modest stipend given you for a day in Congress when you are away from the Capitol, you are going to find it difficult to make ends meet on the prices that we have to charge in New York. There is a high cost of living in New York. There is a high cost of living here because we pay more for fuel than any part of the country. There is a high cost of living here because the taxes are much more—the taxes on New Yorkers—

Mr. Kelly. They are the highest in the country, aren't they?

Governor Carey. That is right, and I am trying to bring them down, and that takes courage, not a lack of it. And it took a long time to get to that point. As Congressman LaFalce said, it took a long time to get in the condition in which we find ourselves.

And just let me make this one point clear with you: That is, that when you talk about the level of grants—there hasn't been a grant level increase to those who receive Aid for Dependent Children since 1974. I wonder how many people could get along today on what they were making in 1974. And those dependent in our City, the million people who are on welfare, and the million illegal resident aliens who are in the metropolitan area, were not thrown in to the City because we have some policy to do so; it is the failure of the Federal programs elsewhere that brought them to our doors, and we take care of them.

Mr. Kelly. Governor, let me ask you this—

Governor Carey. Let me say one more thing in terms of courage: It must have taken some courage and determination to put a freeze on the compensation of all public employees, which has been in effect since the beginning of the seasonal loan agreement, and that freeze is one of the things that we enacted in the State legislature. Wages have been frozen.

Mr. Kelly. There have been wage increases in New York City since that time. They have been called cost-of-living increases.

Governor Carey. Cost-of-living adjustments.

Mr. Kelly. Excuse me, I did not get the terminology right.

Governor Carey. Cost-of-living adjustments that could be paid only out of productivity or other revenues produced by the system itself; no increase in revenues to pay for increases in compensation.

Mr. Kelly. Mr. Chairman, I have been advised that my time has expired. But in order for these hearings to be meaningful, I think we have to have some latitude to examine the witnesses; otherwise, we just use our subcommittee as a platform for propaganda and not for the truth-seeking process.

Chairman Moorhead. Well, to be fair to all members of the subcommittee, I am going to have to adhere to the 5-minute rule.

Mr. Kelly. Well, I would agree that I should not have any special privilege. I am talking about that every member should have a greater opportunity, because we have two witnesses, a very deep subject, and to allow 5 minutes for two witnesses is just not adequate. And the quality of the hearing will suffer from it.

Chairman Moorhead. The gentleman will know that we are going to have hearings in January which will not be so compressed as these hearings of necessity are.

Mr. LaFalce.
Mr. LaFalce. Thank you, Mr. Chairman.
Within my 5 minutes, I just want to make a couple of points, and then a few questions.

First of all, I too am very glad that Kentucky is doing so well, and I would like to think that when Kentucky wasn’t doing so well, that some of the Federal programs that we enacted were able to assist it in its endeavors, such as the Rural Development Act, the creation of the Farmers’ Home Administration.

I am glad, for example, that last year we increased the business and industrial loan and loan guarantee program of the Farmers’ Home Administration from about $3 million to $1 billion available in 1 year only for municipalities under 50,000 in population. Perhaps we should do the same for municipalities in excess of 1 million in population.

Also, I think it is important to give special praise to Congressman McKinney and Stanton at this point who were so helpful in the past, and whose help is going to be so necessary in the future.

Congressman McKinney, as ranking minority member in 1975, came up with a bill that I think if enacted would have meant that we would not have to be here today. Congressman Stanton worked with the then President to bring before us at that time the only bill which could be passed, and we needed some relief at the time that it was passed.

It was the seasonal loan bill, although I think everyone realized that it was going to bring us back today, that it was a temporary interim palliative, and that what we really needed was some kind of long-term financing, whether it be a loan, or much more preferably, a guarantee.

But Mr. Rohatyn, if we were to do what I think is necessary, that is, come forth with some type of long-term guarantee, I have got some problems.

Now, first, I agree that a seasonal loan is too blunt of a weapon. It really means you are going to have recurring problems; you aren’t going to be able to deal with the types of things that are necessary to get out of the problem. It is too blunt, too forceful; the alternative is bankruptcy.

On the other hand, you said that what we really need is long-term monitoring. Now, I don’t think that is good enough, because you need something more than monitoring. You can monitor all you want, but if you don’t have some effective weapon or tool as a surgical instrument, all the monitoring in the world won’t do any good. There must be some way of enforcing what you see during the monitoring period, enforcing changes. And once you give a long-term guarantee, I don’t think you can say, we will review that guarantee in 2 years or 4 years or 6 years; otherwise it would not be a long-term guarantee.

Now, maybe I am wrong, but I don’t see any way where we can technically correct that problem, which leaves us with only one solution. And that is, a long-term guarantee, but making it so painful that you will force the City of New York and the State of New York to get out of it, to want to get out of it. And that is what you came up with as a suggestion.

But yet, I want you to expatiate upon that a little bit more, because that seems to me to be the only course that we can and should take.

Mr. Rohatyn. Well, if I can comment on that.
First of all, "monitoring" is a word. I said we needed a surgical instrument.

I think the monitor, whatever long-term monitor is created, ought to have, from time to time, surgical powers. Those powers, however, should only, in my judgment—in terms of the way this City is run, in terms of preserving the structure of government—come into play if and when the City goes out of balance again.

Now, I am getting into some very technical areas, but there is no question in my mind that any viable long-term monitor will have, within itself, an almost automatic regulator.

Mr. LaFalce. Do you mean the ability of the Federal Government to make decisions?

Mr. Rohatyn. The ability of a trustee to say, "Your bonds are in default. Mr. Mayor or Mr. Chairman of MAC, unless the City undertakes the following budgetary actions in toto," without ever attempting to tell the mayor where he is supposed to cut his budget.

And I think that if that regulator were to work consistently, then you wouldn't ever have the kind of situation that we faced in the fall of 1975, where you had an accumulation of $8 billion or $4 billion of past deficits.

Now let me get to the question of a punitive structure. I think that whatever way this is structured, it should be in the great economic interest of the City to get out of it, and to get the Federal Government out of it as soon as possible. I think that should take place through the market mechanism.

The City, if you have a long-term Government-guaranteed loan, it should not be really very difficult for the City, as soon as it gets its house in order, to finance substantially cheaper in the tax-free market than in the taxable market.

However, again, there ought to be a just measure in all things. We had to finance at 10 1/2 and 11 percent in the summer of 1975. We have put hundreds of millions of dollars of interest cost on the budget of the City needlessly. And this is all very counterproductive.

So I say to you, make it in the interest of the City to get out as soon as possible, but don't kill the City with the euro by making it so punitive as to be nonproductive.

And I can guarantee you that we can structure a monitor that will do the job.

Mr. LaFalce. My time has expired. I would certainly like to explore that, but we will in private, I am sure.

Chairman Moonhead. Mr. Caputo.

Mr. Caputo. Thank you, Mr. Chairman.

Mr. Rohatyn, I wanted to explore with you the value to the U.S. Treasury of the seasonal loan program to date. I mentioned the direct and rather obvious contribution to the Treasury that the loan program has made; that is, the spread between the low interest that the Federal Government borrowed and the rather higher interest that it loaned to the City and that comes to $22 million; and if you want to deduct from that the cost of administering the loan, the Federal Government made $20 million.

Mr. Rohatyn. The payroll of the Assistant Secretary of the Treasury is what you deduct from that.
Mr. Caputo. I think you added to that substantially more, something like $200 million. And as I understand that, that would be taking the average outstanding balance of $2 billion at any one point in time over 3 years and imputing to that some kind of interest rate that would have been charged if that had been financed on a taxable basis.

Mr. Romaine. If the City were financing in its normal course, it would be financing in the tax-free market. The City is being financed by Federal loans, in effect, that are sold in taxable form.

Now if you take a 7½ percent Federal Treasury bond, at 7½ percent, if that is the average rate, that produces interest of about $200 million a year. Now, take a 35 percent tax rate, which is, say, for the average taxpayer, that is $70 million over a year in taxes that the Federal Government is collecting that it would not collect otherwise, and multiply that by 3, that is $210 million; and add the $20 million of service charges, and you are at $250 to $300 million.

Mr. Caputo. I was tempted to make that point, and I never have been able to convince anybody that it is true. I think it is quite true that but for these loans the Treasury would have received $200 million less in revenue.

Mr. Romaine. That is correct.

Mr. Caputo. And that is in addition to the obvious $20 million that it got as a result of borrowing low and lending high to New York City. This has been a quarter of a billion windfall, windfall not in the perjorative sense, but in the sense that it was otherwise not expected to the Federal Government, and not a drain on the Treasury, and not a burden on the taxpayers.

I would like to explore with both you and the Governor the need for the seasonal loan. I agree that long-term financing is ultimately necessary. It would be desirable to get it soon rather than later. It would have been desirable to get it 3 years ago rather than now.

But aren’t these seasonal loans useful for helping us continue the progress already made toward an ultimate solution that we won’t—and I don’t want to paraphrase you unfairly—we won’t be coming back if the seasonal loans are extended 3 years from now in worse condition, we may be coming back, we may not; but the process of progress toward solution—that is, balancing of budgets, stretching out the debt, recapitalizing and controlling expenditures—will continue for another 3-year period; and it is likely that we will be in better condition 3 years from now.

That is our intent, our plan, and our expectation, and to that extent, a seasonal loan program, while less desirable than long-term financing, is still a constructive and useful thing from the point of view of the City, the State, and the Federal Government.

Mr. Romaine. Well, a seasonal loan program, if that is all there is, is the only alternative to bankruptcy. And from that point of view, it is obviously a desirable program.

The memorandum that we submitted to the Governor recommends a combination of seasonal loans that phase out and long-term financing that phases in.

Just to go to your point—

Governor Carey. If we knew the seasonal loan program were to be extended in some form for a limited time, that would resolve the un-
certainty and take away the trauma of bankruptcy which is being repeated more and more.

In the hearings before the other body, Mr. Rohatyn made the careful and candid observation that the more talk of bankruptcy that was being floated at those hearings, the more difficult it was going to be for him to continue his MAC financing, and the contemplation that that would be seasonal loan continuation, for a limited period while we try to work out and put in place the longer term, that would be the ideal combination.

Mr. Caputo, I would like to continue if I may, Governor Carey. It seems to me that the principal reason we need your advice today is to comment on what the State of New York has done during the period that the Federal Government has been making the seasonal loans.

The thrust of your statement that while the Federal Government loaned about $2 billion, the State of New York, something like one-tenth the size of the Federal Government, loaned $3.3 billion, substantially more than the Federal Government, and that during that period, State aid to the City increased by about one-half billion dollars.

Is that a fair summary?

Governor Carey, it is in the neighborhood of $300 million for the period 1973–74 to 1976–77. And so far as the effort of the State is concerned, it must be taken into consideration that early on we took a calculated but a clear-cut risk in picking up $75 million of the original MAC. I can tell you now that it was just at the stroke of 11:50 that we were able to repay, or secure the repayment of the last $250 million of that. I did take the State to the very ultimate level of risk that I could reasonably and cautiously be expected to do.

And we did inaugurate this $800 million advance because had we not made that $800 million available in May of 1975, then the default would have occurred at that point. And that is what has been going on—that $800 million advance and repayment which takes us over into another fiscal year.

Each year since 1976 these measures have been undertaken. But the hope and anticipation is that with a better economic base and a better system of taxation, the economic recovery that we have experienced in other parts of the State where we have gained some 100,000 jobs would also obtain as far as New York City is concerned.

As far as the welfare caseload and the limits we have put in place with Medicaid and welfare, that would continue the path of austerity and corrective measures, and would put the City and the State on the same path of austerity that is needed.

Mr. Caputo, my time has expired, but I would just like confirmation that the money loaned from the State to the City over the last 3 years has been loaned at the State's borrowing cost; no profit was made by the State in the manner that the Federal Government made profit on the loans.

Governor Carey, no; the City has paid the cost of borrowing. But it has increased the size of the borrowing of the State, which in turn has increased the cost of the debt service of the State.

Mr. Caputo, thank you, Mr. Chairman.
Chairman Moorman, Mr. Koch.
Mr. Koch, Mr. Chairman, thank you.
First, I would like to say that the Governor and Mr. Rohatyn have contributed extraordinarily to the saving of the City of New York. The Governor, in particular, is the single individual who has done more than anyone else in this State. He is responsible for making it possible to resurrect the City.

Second, I practiced law before I was elected to the Congress in 1968. The rule normally is, never redirect testimony of a good witness, where he was accurate, and has stated the case without ambiguity, and has done it brilliantly, as these two men have.

I am going to violate that rule because I think there are some additional items that it would be helpful to have on the table.

One is: Isn't it true, Governor, that the City of New York, since the financial crunch in 1975, has in fact eliminated 60,000 or more employees from the payroll?

Governor Carey. That is a fact; that is clear and definite; yes.

Mr. Koch. And isn't it a fact Governor, that since the financial crunch in 1975, that with respect to new pensions, they have been considerably reduced?

Governor Carey. Yes; the Eckhardt legislation in the State, and the ITHP agreement that was secured by Mr. Rohatyn with the unions are in place.

Mr. Koch. And isn't it a fact, Governor, that if the bill that the City of New York pays each and every year of perhaps $1 billion or more for welfare, and medicaid, were to be removed from the shoulders of the taxpayers of the City of New York, that we would not have a financial crunch in the City of New York.

Governor Carey. Very true.

Mr. Koch. I rest my case.

Chairman Moorhead. Thank you very much, Governor, Mr. Rohatyn.

Next year hopefully we will have a legislation package to discuss, and we will be able to discuss the situation at greater length than we can in an abbreviated preliminary session such as we have today.

But I think you have set the framework for the creation of that sort of legislation, and I think your testimony has been extremely helpful.

We thank you both very, very much.

Governor Carey. Thank you, Mr. Chairman.

Mr. Rohatyn. Thank you, Mr. Chairman.

Chairman Moorhead. The subcommittee will take a 3-minute break.

[The subcommittee would now like to hear from Mr. Gedale B. Horowitz, general partner in Salomon Bros.; Mr. Brenton W. Harries, president of Standard & Poor's Corp.; Mr. Jackson Phillips, executive vice president of Moody's Investors Service, Inc.; and Mr. Amos T. Beason, senior vice president of Morgan Guaranty Trust Co.

We might as well proceed in that order. We will hear all four of you, and then proceed under the question and answer period.

Mr. Horowitz, would you lead off, sir?]
STATEMENT OF GEDALE B. HOROWITZ, GENERAL PARTNER OF
SALOMON BROS., NEW YORK, N.Y.

Mr. Horowitz. Thank you, Mr. Chairman.
Mr. Chairman and members of the committee, I am Gedale B. Horowitz, general partner of Salomon Bros., in charge of its municipal bond department. The subcommittee staff has requested that I respond to four questions regarding New York City’s progress toward financial recovery and the prospects for its return to the market.

The first two questions are:
One, has New York City made progress toward fiscal and financial stability?
Two, how does the investment community perceive New York’s performance of the past 3 years?

Because these questions are related, I will answer them together.

I believe, and I think my view is shared by the investment community, that while much uncertainty remains for the future, some important progress has been made. To put this progress into context, I would like, with your indulgence, to discuss briefly some basic background information about the municipal bond market.

For a fixed-income security to be marketable, there must be a high degree of certainty that income and principal will be paid when due. Ideologically nonpayment should be inconceivable. Facts which give rise to uncertainty in this area will result in a risk premium over and above the basic prevailing interest rate. If the possibility of nonpayment is perceived as significant, there will be little or no market for the security. There is no amount of interest which can compensate investors for a significant risk of nonpayment.

This does not mean that State or local governments experiencing financial difficulties will be unable to market their debt at reasonable interest rates. Over the years governmental issuers have devoted considerable effort to establishing the principle that their debt will be paid even in time of severe financial difficulty. This pledge, as reflected in the constitutions and laws of the various States and local governments, affords a measure of financial independence and resiliency. Without investor confidence that debt will be paid in good times and bad, only the most financially secure States and localities could be assured market access.

While not directly related to the questions raised by the subcommittee, I do want to note in passing my view that default in times of distress is therefore no answer. Many years may be required before a defaulting municipality can market its debt. For example, several municipalities defaulted during the depression and were denied market access for a good number of years.

There must of course be reason to believe that the pledge of payment will be observed; that a general obligation pledge of faith and credit is not just so many words engraved on the face of a bond or note.

Three circumstances generally provide this assurance:

The legal obligation of the issuer should be unequivocal;
Fulfillment of the legal obligation should be feasible; and

...
Financial reporting by the issuer and the resolve of its management should be credible.

Some progress has been made in each of these critical areas. The New York State Court of Appeals has reaffirmed the binding nature of a pledge of faith and credit and pursuant to this decision the City has paid or provided for the payment of approximately $1.8 billion of moratorium notes. This was an essential first step in showing investors that the City can meet its obligations and has in addition provided important support for the integrity of municipal debt generally.

The City has also demonstrated its ability to prepare and live within a 3-year financial plan. While the plan permits substantial departures from generally accepted municipal accounting principles, it nonetheless does represent a degree of fiscal discipline. For fiscal year 1976 the City comptroller reported an actual expense budget deficit of $968 million which was $83 million less than the deficit contemplated for the financial plan for that year.

While the City may not have achieved a balanced budget, in order to live within its financial plan it has reported a number of expenditure reductions and revenue measures: Tuition has been imposed for City universities, additional State support for certain court and higher education functions has been provided, levels of City employment have been reduced, MAC debt has been extended, and the City has negotiated agreements with municipal labor unions that are consistent with financial plan assumptions and the Control Board wage guidelines.

A system of budgeting and financial planning can only be credible to an investor if the reporting system behind it is believable. The Federal loan agreement of December 30, 1975, is an impetus toward effective financial reporting since it requires that by July 1, 1977, the City will have established an accounting system which will provide for a system of records and controls which would enable an auditor to perform an annual audit and render an opinion thereon. The integrated financial management system, put into operation by the City on June 30, 1977, is intended to enable the City to report its financial operations in accordance with generally accepted accounting principles as well as to meet State and Federal credit agreement reporting requirements. Adoption of the State comptroller's uniform system of accounts for municipalities as modified and current efforts to provide an independent audit of the City's books for the 1978 fiscal year are also important steps.

Another important area of progress is the funding of a substantial portion of the City's accumulated deficit through the issuance of MAC debt. The volume and improving interest costs at which MAC debt has been sold are encouraging.

Your last two questions are:

What more is required for the City to be able to return to the market? For seasonal needs? For long-term capital needs?

When is return to the market likely to occur? These questions are related as well.

The progress that the City has made to date should not be confused with the further steps that I believe are necessary for market access. The City projects large budget gaps for the fiscal years after 1978,
gaps which would be even greater were the City to be held to compliance with generally accepted accounting principles. The former executive director of the Control Board has stated that in the absence of significant new revenues, the analysis of the staff of the Control Board suggested that by the 1981 fiscal year the City could have a deficit which would approach the levels reached at the beginning of the financial emergency.

Despite continuing problems, once the administration fully spells out the complete magnitude of the City's total financial problems and indicates to the market a realistic and achievable approach to these financial difficulties, some conceivable level of seasonal borrowing—possibly on the order of $250 million to $500 million—can probably be accomplished. This conclusion depends on the renewal of the Federal credit agreement and the set-aside of the specific revenues for payment of notes in the manner provided for in the recently attempted revenue anticipation note offering. An improved short-term credit rating would, of course, be highly desirable and is necessary if excessive interest cost is to be avoided.

While the City may not be far from market access for a portion of seasonal needs, and indeed, the recently attempted note sale came very close to succeeding, a comprehensive plan to restore investor confidence in the worth of City general obligation debt is required before access to the long-term market can be achieved. The issuance of short-term debt secured by special set-aside provisions will not in and of itself establish the City's credit, but can be part of an overall plan to restore investor confidence in the worth of the City's general obligation debt.

What is needed above all is an atmosphere that encompasses both the accuracy of financial data and the candor and vigor of management. Full recognition of the City's entire problem and a plan for its resolution is the setting which investors will require. It is not conducive to the sale of securities to bring forward the City's financial problems on a piecemeal basis. The investor must be given a clear picture of the magnitude of the entire problem. For example, it has been reported that the City's past figures and current estimates may be subject to material revision upon full implementation of IFMS. Until financial reporting is fully established, it is unlikely that the City will be able to market long-term debt. Internal reporting alone will in any event not likely be sufficient. Continued independent audits and an auditor's report that provides reasonable assurance regarding the accuracy of financial data will also be necessary.

It is apparent to me that the long-term investor will want an oversight mechanism to help assure that the City will not one day fall back into its 1975 condition. The exact nature of an oversight mechanism is a thorny issue, affecting as it does the important principle of popular home rule. It must be molded to the specifics of the situation and of the needs of various groups. Whatever the form of oversight body ultimately decided upon, the existence of such a body should provide some assurance to the bond and note investor that the City's problems will not escalate to the point where a choice has to be made between maintaining vital services and meeting debt repayment obligations.
It should provide an early warning system for pinpointing difficulties and possibly a trigger mechanism for corrective measures.

The existing oversight mechanism and 3-year financial plan have enabled the City to make progress as described. What is needed now is a new long-term financial plan which, under continued oversight, will bring about a truly balanced budget in accordance with generally accepted accounting principles. Before the City can return to the long-term market, there must be sufficient track record under that plan so that the investor knows that the balanced budget objective is likely to be achieved.

Even under the existing 10-year phaseout of capital financing of operating expenses, the absolute level of such capitalized expenses is still substantial: They are estimated at $643 million for fiscal 1977-78. Marketability of long-term debt within the foreseeable future necessitates an accelerated phaseout of this practice. In addition, the pension funds must be placed on a sound actuarial basis and the $800 million State advance should be funded out. The oversight mechanism as continued must have adequate enforcement powers to assure proper implementation of a plan which achieves these objectives. In addition to financial controls, issuance of long-term debt will be facilitated by the creation of new security mechanisms such as a debt service fund and appropriate limitations on the issuance of short-term debt.

The arrangements described above are not intended to be a comprehensive list but rather a summary of the kinds of actions that will have to be taken. Once the City begins implementing such measures under a new long-term plan, and as its access to the short-term market improves, it will be possible to phase out the Federal seasonal loan program. However, until the City can issue long-term debt on its own, it will probably be necessary to provide capital financing through MAC.

Finally, a program for the City’s return to the bond markets must recognize that the investor will weigh the City’s long-term economic health together with fiscal factors. It may well be that the City’s economy cannot be put on a solid basis without some new Federal assistance. There can be no doubt that one of our pressing national problems is to find a way to build up the economy of those areas which are experiencing a deterioration in their revenue base.

In conclusion and in summary, the magnitude of the City’s continued problems is such that while it may be able to finance a portion of its seasonal needs in the near future, it is not yet possible to predict when the City will be in a position to return to the market for its long-term needs. Risk-reward relationship is a basic principle under which all security markets function and is not a relationship that is currently perceivable by investors for New York City long-term securities. In order to reestablish the City long-term market, the investor must have confidence in the ability of the City to recognize and understand its problems and solve them.

Thank you.

Chairman Moorhead. Thank you, Mr. Horowitz.

Mr. Harries?
STATEMENT OF BRENTON W. HARRIES, PRESIDENT, STANDARD & POOR'S CORP.

Mr. Harries, Mr. Chairman, in the interests of time and brevity, I have submitted a statement to the subcommittee. I would much prefer, if I may, to yield my time to the members for questions.

I would, however, like to graphically depict the answer to one of the questions which was put to me. This graph is reproduced as the last page of my statement, and I apologize to the people sitting in back of me who won't be able to see this when I put it up, and to my good competitor friend, Mr. Phillips, who I am going to put it in front of.

This rather graphically depicts, I think, how the market and investment community perceive New York City right at the moment as to its bonds. You will note that the City is selling at around 8, then 75 basis points up in 3 years to 1980, and in 1990 rises to something like 9.25 percent. And these are yields. If the bonds were priced at 100, that would be equivalent to an interest rate.

Then notice the peculiar hump in the New York City curve, and how it drops the farther the bonds go out. One of the things I believe this indicates is that investors are more confident of the longer term viability of New York City than they are of its ability to meet its short-term problems.

I showed Boston, Mass., only to give you a point of reference, as Boston being an older northeastern city with some of the same problems of urban decay and other things, Suffolk County is also suffering some of the New York syndrome. I included it because it is located in New York. Then I showed what I would call a sunbelt city, New Orleans, paying less than 4 percent out and going slightly over 5 percent in over 30 years—or over 20 years.

I am sorry I don't include more bonds of some of your constituencies, but I can tell you offhand that Philadelphia would be somewhere between the 5- and the 6-percent level; Hartford would be down around New Orleans.

With those comments I will pause and welcome your questions.

Chairman Moonan. Thank you, Mr. Harries, and without objection, your entire statement and the attachments thereto will be made a part of the record.

[Mr. Harries' prepared statement with attachments follow:]
STATEMENT OF
BRENTON W. HARRIES, PRESIDENT, STANDARD & POOR'S CORPORATION
TO THE SUBCOMMITTEE ON ECONOMIC STABILIZATION
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
December 16, 1977

When I last appeared before this Committee in October, 1975, I pleaded for
a Federal loan to New York State, which in turn would minister the needs of New
York City to prevent what to me was an unacceptable happening - a New York City
bankruptcy. I pleaded for a $6 billion loan, not the $2.5 billion enacted. I
suggested the larger amount so as to prevent the default of New York City notes,
which unfortunately took place.

Since 1975 the short term note problem has been handled largely by the
financings of the Municipal Assistance Corporation and borrowing through the City
pension funds. The City has met and is continuing to meet interest and principle
payments on its bonds. No bond holder who has held his bonds to maturity has
suffered a penny of loss or a day of repayment.

As to the future and answers to some of the questions posed by the Committee's
request for me to testify, let me state at the outset that, in my opinion, the City
will be unable to borrow in the public debt market in a meaningful way until it
can demonstrate fiscal stability through dependably balanced budgets and an out-
side monitoring mechanism.

The recent aborted New York City note sale was in my mind not a test of the
ability of the City to reenter the capital market. Contrary to a widely held and
incorrect belief, fostered in part by erroneous statements contained in the Securities
and Exchange Commission Staff Report on Transactions in Securities of the City of
New York, Standard & Poor's Corporation, with very few exceptions, does not rate
municipal notes and at no time ever rated New York City notes. However, in the case
of the recent attempted sale the City kindly shared with us the offering documents
and met with us to further explain the security behind the notes.

The repayment of those notes depended not on the City's ability to generate
cash revenues in excess of expenses in order to repay - a basic test of credit
worthiness - but rather on whether or not New York State would appropriate funds and whether or not New York State could borrow to raise cash to meet the appropriation. This was no test of the City's credit.

(Because of the difficulties engendered by the inaccuracies in the Staff Report I wrote the Chairman on September 16, 1977. A copy of my letter is attached to this statement.)

A real test of the City's ability to borrow for itself will be found in an affirmative answer to the following question:

Can the City sell meaningful amounts of its general obligation bonds with maturities that provide attainable repayment periods, at interest rates which are not burdensome penalties?

The answer to that question today is no, not because of the pressured and unsuccessful note sale of last month, but rather because of the perceived inability of the City to be expected to operate within a balanced budget for a consistent period.

This perception is readily demonstrated by seeing where New York City's bonds are selling today relative to other credits. I have attached to this statement a graph depicting in very simplified terms this comparison.

Two points are readily apparent. First, New York City sells at substantially higher yields than many municipal credits. Note how much smaller are yields on Boston, another aging Northeast city; note Suffolk County with yields reflecting the fact that it is in New York State, which itself has been tainted by the City's problems; and note New Orleans, a single A credit, away from the problems of New York City, selling at interest rates about half of the City's cost.

Second, notice the hump in the yield curve on the City. I think this results from two things: first, the City's bonded debt is quite short with the great bulk of debt maturing before 1990 and included are many bonds with low coupons issued before the crisis; and second, investors are more confident of the
long term viability of the City than they are of its capability to overcome foreseeable problems in the shorter term. They see the immediate problem in the next few years of the budget imbalances; this is a known fact. The financial condition of a New York City in fifteen years is not so clearly perceived and known to be so severe a problem, so optimism overcomes ignorance.

Among the many critical issues plaguing the City and of course causing concern to prospective investors as they look to 1978 and beyond are these:

1. What will the Congress do? If the Federal loan program is not renewed while the City is still unable to finance its seasonal needs itself the alternative is clear bankruptcy.

2. Can New York State do more to help New York City than it has already done? The answer is very little without undertaking such major steps that the State's own improved credit position would be severely weakened. New York State's own debt burden is already high when MAC debt is added on to the State's own debt. The State's finances, while showing some improvement recently, could easily slide badly in the next economic downturn. And New York State's economy, even now, is less than robust.

3. What about some of the municipal labor contracts that are up for renewal in 1978?

4. Is the new City administration capable of coping with the fiscal crisis?

5. Can nothing be done to blunt the deadly impact of future pension liability?

6. What will be the effect of the political posture of New York State in a gubernatorial election year?

7. What happens after the Emergency Financial Control Board no longer has fiscal oversight of the City? I believe it essential for investor confidence that some outside fiscal monitor have oversight.

8. Lower taxes, decontrol of rents, business incentives, better street repair and general housekeeping must be perceived to be in the offing to help restore business confidence and prevent further erosion of the tax base.
9. Isn't fiscal gimmickry still occurring with the continuing borrowing in the capital budget for operating expenses? Although this is to be phased out, there is uncertainty in investors and underwriters as to the practical problems of completing the phase out.

10. Perhaps most importantly, how can the City expect to borrow if it can't live within its means? Future budgets are not in balance. Inability to borrow to fill budget gaps will trigger unfortunate choices - meet essential services or meet debt service? Unfortunately, the City has proven that it will pay firemen and policemen before bondholders.

One of the major contributing reasons for the City's financial difficulties of the past few years has been its deteriorating economy. Since its peak in 1969, the City has lost 600,000 jobs, or nearly 15% of its total employment. Studies have estimated that these job losses resulted in a loss of almost $1 billion in revenues to the City from various sources. Certainly, before the City can recover the long-term market, some indications of stability in the City economy must become evident. Some indications do exist that the City's job losses are slowing, with manufacturing showing virtually no loss since 1975, and certain service and financial sectors actually are showing some growth due to the influx of international business operations. In fiscal 1977, sales tax collections increased by 7%, the first time since 1973 that the increase outpaced the rate of inflation. One year is not a trend, however, and once before, in 1973 before the last recession, similar economic signals were indicated. Many were fooled. It will take perhaps two more years or longer to determine that the economy has reached equilibrium.

Additionally, the tax burden remains extremely heavy, particularly on personal and corporate income. Yet, with some small exceptions, the city is virtually locked into the present high level of taxation unless some of its social welfare costs are picked up by higher units of government. Tax cuts are essential, however, to economic improvement, hence we have a vicious circle. Perhaps compounding this problem is the fact that New York State also levies heavy taxes allowing it less
flexibility in aiding the city in reducing taxes. Finally, there is growing concer
regarding the lack of essential maintenance of city facilities—bridges, roads, 
schools, and so on—so that at some point this piper will also have to be paid, and the 
price tag could be huge.

I did not attempt an exhaustive listing of the City's problems—that's not
practical for our purposes here. Rather, I've tried to indicate some of the things
that are on the minds of investors and why they are keeping the market door closed
to New York City.

In light of this outlook, let me expand on the question of the State's
ability to help the city either with its short-term or long-term needs. One of
the major causes of the city's seasonal financing problems, is the State and its
pattern of seasonal financing. For the state to substantially alter its pattern
of financing and thus aid the city, two major (and very costly) moves would have
to be made. First, the fiscal year would have to be shifted to bring it in line
with New York City's June 30 (the State is on an unusual March 31 Fiscal year).

Other states and cities have shifted fiscal years, and normally have had
to do substantial borrowing or raise taxes in the year of changeover. Neither
is an encouraging prospect for New York State. The second method for easing sea-
nonal needs is to revamp the revenue collection methods to even out receipts over
the year, thus allowing more even disbursements of appropriations. While this
approach has some merit, it is also a hidden method of increasing taxes, since
business, in particular, does not enjoy the money float if taxes have to be remitted
more often.

If New York State's options on helping the city with its short-term needs are
few, its ability to help the city with its long-term needs is even less. For the
State to give some form of long-term loan to the city would, in turn, require the
state to sell General Obligation bonds. Such bonds may only be authorized by the
voters whose approval would be doubtful. Another "moral obligation" agency could
be set up as an alternative, but the creditworthiness of such an entity would be
questionable since the prospects of repayment of any long-term loan by the City is regarded as slight at this time. And to reiterate, New York State is already bumping the limits of its resources.

As to the NYS Staff Report on New York City, I have mentioned the problems engendered by the erroneous statements about note ratings. In addition the staff concluded that we had failed to conduct "diligent inquiry" relative to the City's finances. We take strong exception to this finding, and believe that an unbiased examination of the record fails to provide a basis for such a conclusion.

The Staff Report states (Ch. v, p. 2)

"Nor did they (rating agencies) apparently recognize a responsibility to make diligent inquiry, even in the face of adverse facts which came to their attention."

If the Report means that S & P was supposed to make inquiry when no adverse or inadequate facts were present, then that premise must assume a presumption of falsity or fraud on the part of a public official in the performance of his duties. In the absence of materially adverse facts, that premise asserts that every public official is guilty until proven innocent. In that connection, it must be remembered that there were no challenges to the City's reports by law enforcement officials of the City or the State. And the official written criticism by State Controller Levitt was not made until the summer of 1975, months after S & P had taken the step of suspending its rating of the City's bonds on April 2, 1975. And it must be reassessed and remembered that S & P never rated the City's notes, but only its bonds. It was not until March 20, 1975 that any red alert occurred with regard to such bonds. Indeed, it must be reassessed and remembered that the City's bonds have never suffered any default of any kind whatever.

On the other hand, if the statement is an assertion that there were adverse facts which came to S & P's attention, but that S & P did not make diligent inquiry in the face of those facts, then the record refutes the assertion. In answer to questioning by the Staff, we testified that, during the period 1970 to February,
1976, S & P representatives had somewhere between seven and nine personal meetings with City officials; that S & P followed the City's fortunes on a continuing basis; and that S & P continually reviewed the City's reports.

Following the raising of the rating from triple B to single A in December, 1973, and on December 17, 1973, the New York Times published a statement that advisers to Mayor Beame were projecting a budget deficit for the fiscal year ending June 30, 1974 of 1.3 billion. On December 18, 1973, the City Budget Director, David Grossman, informed us that the real figure would more likely be $300 million. The Staff Report states that S & P "made no further inquiry during the conversation into the reasons for the discrepancy in the basis for (David) Grossman's conclusion" (Ch. v. p. 18). That projection of $300 million represented a budget figure by the Budget Director. There was no fault in relying thereon. In my opinion, S & P was entitled to place more credence on a budget projection made by the Budget Director of the City of New York, than upon a newspaper report, particularly when that projection substantiated the representations made at the prior meeting in September, 1973.

The Report itself refutes any lack of due diligence. The Report states (Ch. v. p. 8):

"IV. Information Requirements

Both agencies require that certain data be supplied to them prior to the issuance of a rating including annual financial reports, budget figures, tax collection statements (including the tax levy and the taxes actually collected), long-term investment plans, debt statements including maturities, assessed valuation of realty and personalty, information dealing with specific economic and legal conditions (e.g., population estimates and trends, school enrollments, building activity, etc.) as well as reports from academic sources or private research
organizations with respect to the municipality.
In addition to the information that is requested
at the time of the initial rating, both agencies
request updated information in order to ensure that
their credit ratings reflect any subsequent change
in the condition of the issuer. Both agencies
maintain that they rely on the entity submitting
the data for its accuracy and do not attempt to
verify the information received.1

There is nothing in the Report that substantiates that S & P did not follow
the above procedures. Assuming that there may be a legitimate difference of
opinion between the SCH staff and us, let me say that our rating was independent,
objective and appropriate at all times under the existing circumstances.

In conclusion let me state that although I am quite pessimistic on the City's
ability to reenter the credit markets for both seasonal and long-term needs in the
near future, I am quite bullish on the long-term viability of New York City to
be the financial center of the United States. I believe that being located close
to this center is essential to the continuing success of Standard & Poor's business
and future growth and profitability. I have faith that, with State and Federal
financial assistance and guidance the City will be able to overcome its current
problems which are symptomatic of those facing other older cities, and emerge
stronger. Standard & Poor's Corporation demonstrated that faith last week by
committing itself to a new headquarters building in lower Manhattan with a long-
term lease.

Thank you for the opportunity to testify on these crucial matters and I will
be pleased to answer questions.
September 16, 1977

Chairman Harold M. Williams
Securities & Exchange Commission
500 North Capitol Street, N.W.
Washington, D.C. 20549

Dear Chairman Williams:

With the release of the Staff Report on Transactions in Securities of the City of New York, Standard & Poor’s Corporation has been plagued by a series of inaccurate reports relating to Standard & Poor’s ratings on New York City’s notes. The fact is there were no such ratings by this company.

Much of this confusion seems to stem from the Staff Report. For example:

SEC Staff Report

Chapter Five, page 4, states:

"However, unlike Moody’s which rates bonds and notes, S & P’s ratings are confined mainly to bonds. (underlined supplied)

"4. As used herein, the term ‘notes’ refers to short-term obligations; the term ‘bonds’ refers to obligations with long-term maturities. S & P did not rate the City’s notes during the period covered by the investigation. Testimony of Hyman Grossman, Vice President of S & P (hereinafter referred to as "H. Grossman") at 54-55 (February 6, 1976). (underlining supplied)

Chapter Five, page 1, states:

"During the period covered by the investigation, as shown below, billions of dollars of New York City’s securities were sold and traded predicated upon ratings..."
S & P never rated New York City's notes at any time whatever. S & P rated only the City's bonds, which have not been and are not in default. Debt service on the bonds is being paid regularly. In material furnished the staff in addi-
tion to the testimony, we provided copies of speeches and other information ex-
plaining why I felt trying to rate City notes would be a poor business venture.
To have avoided this pitfall and then to be tarred with the same brush because of
poor drafting by the Staff, is grossly unfair and I would hope something could be
done to correct it.

The Report compounds this inaccuracy by stating (Chapter Five, p. 26):

"Indeed, following the cancellation of the TAN sale in late
February 1975, Moody's and apparently S & P accepted the City's
explanation for its action without further inquiry into the
reasons for the allegedly "unprecedented request" for financial
information by bond counsel or the City's inability to supply
the information I" (underlining supplied.)

The supporting footnote is based on testimony by Jackson Phillips, a Vice
President of Moody's, who certainly has no association with S & P. It is clearly
inaccurate to say or assume that S & P "accepted" the City's explanation for a
cancellation of TANs, when S & P had nothing whatever to do with such an offering
in the first place.

The Report refers to news articles beginning as early as October, 1974 and
continuing through early 1975 with regard to discrepancies in the size of the
projected year-end deficit, and then goes on to state (Chapter Five, p. 26):

"Despite these events, during the first four months of 1975,
Moody's and S & P did not revise their ratings downward." (underlining supplied)

The statement is patently wrong. S & P did indeed on April 1, 1975 to sus-
pend the rating of the City's bonds, and published the fact of that suspension
on April 2, 1975. This fact is covered in our testimony: (Grossman p. 30)

"Q Sir, from examining that can you tell us what the City
bond ratings were from January, 1970 to the present? (handing
document to the witness.)

A In January, 1970 Triple B, with the same rating of Triple
B going through October, 1973. Then in December of 1973 the
rating is A, continued through February of 1975, and April 2,
1975 the rating is suspended."

Obviously, this unprecedented action of suspending the rating was well
within the four-month period.

The Report claims an alleged failure on the part of the rating agencies
"to make either diligent inquiry into data which called for further investigation," or
to adjust their ratings of the City's securities based on known data in a
manner consistent with standards upon which prior ratings had been based" (Intro-
duction, p. 9). There is no factual basis in the testimony for the statement that
S & P's personal discontinued the application of prior standards in connection with the rating of the City's bonds.

As to "diligent inquiry," and bearing in mind that S & P rated only the City's bonds and never rated the notes, a brief explanation of the background for S & P's suspension of the City's bond rating on April 2, 1975 is in order. As the Report states, on March 20, 1975, two S & P analysts visited Albany for a regular review of the State's financial situation with the State's Director of Budget. During that meeting, the analysts were advised that, based on existing circumstances, the State could not render financial assistance to the City in case of the latter's default. This information was then conveyed to senior S & P personnel. During the period from March 20 to April 1, 1975, and allowing for absence of personnel, S & P's representatives called the banks and City officials seeking to obtain more information, particularly as to cash flow. As a result, on April 1, the decision was made to suspend the rating on the bonds, and published on April 2, though they were not in default.

Prior to the visit on March 20, 1975, S & P continued to review New York City financial reports and to discuss the City's financial affairs with the latter's representatives, as well as with others. Based on the information available to us we believe we adjusted and suspended our bond rating in the most timely manner. The fact that both interest and principal on these bonds continued to be paid on time and without any interruption throughout the City's entire fiscal crisis would seem to support our position in this regard.

I would hope that some clarification of the problem I have mentioned could be made now that the Commission has received the Staff Report. I will be pleased to make myself available at your convenience to discuss this further.

Very truly yours,

Bretton M. Harriss
President
Standard & Poor's Corporation

cc: Messrs. John R. Evans, Esq.,
    Philip A. Loines, Jr., Esq.,
    Irving M. Pollack, Esq.,
    William D. Noren, Esq.
YIELDS ON NEW YORK CITY BONDS AND OTHER GENERAL OBLIGATION CREDITS COMPARED

1980  85  90  95  2000

NEW YORK CITY (NON-RATED)

BOSTON, MASS. (A-RATED)

SUFFOLK CO. (A RATED)

NEW ORLEANS, LA. (A+RATED)
Chairman Moorhead, Mr. Phillips, we would like to hear from you next.

STATEMENT OF JACKSON PHILLIPS, EXECUTIVE VICE PRESIDENT, MOODY'S INVESTORS SERVICE, INC.

Mr. Phillips, Mr. Chairman, members of the subcommittee, my name is Jackson Phillips. I am executive vice president of Moody's Investors Service, Inc., headquartered in New York City, and am also director of the Municipal Bond Research Division of Moody's.

You have asked for our response to the question: Has New York City made progress toward fiscal and financial stability?

The state of the City's financial condition and investor confidence in New York City at this time can be described as fragile, at best. This fragility was underscored again last month when underwriters abandoned an offering of short-term City notes after Moody's had assigned the notes an investment grade rating, although the lowest within that rating range.

Now briefly, the answer is: the City has made progress. We raised our rating in May 1977 from Caa to B, which is "lacking characteristics of the desirable investment." At that time we stated:

The City has made progress over the past 18 months. With the aid of a moratorium on note payments which was declared unconstitutional, and Federal financial assistance, it has avoided bankruptcy and endless legal action. Substantial problems remain, but our view is that the City, having coped thus far, is in a better position to deal with them than it was a year or more ago.

We hold to this view and feel that the note rating we assigned was based largely on the position of New York State in the security, as opposed to the credit worthiness of New York City itself.

Restoration of creditor confidence in New York City is indeed a difficult task. We believe that as a first step in that direction, New York City's financial reporting must be improved and deemed dependable. Despite 2½ years of outside auditors and a myriad of consultants, almost every significant City budget number has been changed not once, but repeatedly. We attach as an appendix to our prepared statement a discussion of the City's accounting and budgeting practices.

You have asked us to comment on the present perception of New York City by the investment community. The response to the City's attempted note offering last month gives some indication of this. Despite the involvement of two of the largest investment houses, which undertook to form an underwriting group, the City's first attempt at entering the credit market since the fiscal crisis was a failure.

It appears to have been recognized that a modest quantity of notes could be underwritten by local houses and placed with local institutions, but such a sale would have no more than local significance. Unless the City was to be restricted to its hometown institutions indefinitely, the participation of the national market was essential.

We can only conjecture as to why the general response to the proposed offering was so negligible although the City itself in its preliminary official statement cited numerous quantifiable risks associated with its securities. The preliminary official statement contained a section entitled, "Summary of Certain Risk Factors." This section enum-
erated 11 risk factors and ran 6 pages. Plainly, prospective purchasers, with many alternative investment opportunities, are repelled by the environment described in the City's statement.

The funds for the payment of the notes were structured to bypass the City competently. The State's direct involvement in the payment process was stressed by the underwriters and City officials in our meetings with them as the primary security for the notes. This built-in recognition of the weakness of New York City probably best categorizes the investment community's perception of it as a financial entity at this time.

You have asked us what is required for the City to return to the market, and when this may occur. We have indicated the magnitude and complexity of the City's problems. Improving the ratings and investment perception of the quality of the City's obligations will require a number of steps on the part of the City. Among these are the following:

One, creation by State law of separate funds to receive and disburse the moneys levied for interest and serial bond and note principal;

Two, repeal by the State legislature of title 6-A to the local finance law;

Three, withdrawal by the State of New York of consent to the filing by local units of petitions under chapter IX of the Federal bankruptcy law;

Four, assurance of the continuation of a fiscal monitor;

Five, clarification of the status of MAC's authorizations and responsibilities;

Six, elimination of the annual rollover of the State advance;

Seven, clarification of the municipal pension/sinking funds' future bond purchasing role;

Eight, more rapid phaseout of the use of bonds to finance current expenses;

Nine, correction of the longstanding imbalance between the expenditures required of the City by the State and the revenue system provided for the City by the State; and

Ten, reform of the longstanding budgetary inadequacies.

As for New York City's prospects, we feel that both the problems and the solutions are too often oversimplified. It has been our hope to suggest that the City's problems go far deeper than accounting, that its failings have been far more serious than merely making overly generous settlements with its unions. The City has disregarded the sound precepts of public administration, has violated the most elementary rules for maintaining fiscal solvency. The progress that the City has made over the past 2½ years is almost wholly attributable to the oversight and management functions which have been performed by the Control Board, MAC, the Treasury and the Congress. Its affairs are being conducted in a more orderly manner. However, until the long-term problems are truly addressed, there will be no realistic prospects of the City becoming once again self-sufficient.

Chairman Moonnape. Thank you, Mr. Phillips. I note that you have in addition to your abbreviated statement a longer statement. And without objection, the statement will be made a part of the record.

[Mr. Phillips prepared statement follows:]
TESTIMONY PRESENTED BEFORE
THE SUBCOMMITTEE ON ECONOMIC STABILIZATION
OF THE HOUSE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
FRIDAY, DECEMBER 16, 1977

BY

JACKSON PHILLIPS
EXECUTIVE VICE PRESIDENT
MOODY'S INVESTORS SERVICE, INC.
My name is Jackson Phillips. I am Executive Vice President and Director of Municipal Bond Research of Moody’s Investors Service, Inc., headquartered in New York City.

**********

I

Progress Toward Fiscal and Financial Stability

You have asked for our response to the question: has New York City made progress toward fiscal and financial stability? As a first step in achieving fiscal stability, financial reporting must be improved and deemed dependable. It is very disquieting at this point, despite two and a half years with outside auditors and a myriad of consultants, that almost every significant number in the ongoing discussion of the City’s financial position has been changed not once, but repeatedly. We attach as an appendix to this statement a discussion of the various versions of the City’s current and prospective budgets.

Former Secretary of the Treasury Simon testified on April 1, 1976, that the City has sustained an operating deficit each year since 1961. During the three years of the Financial Plan the operating deficits have in reality continued. The City’s November 1977 Preliminary Official Statement dated November 10, 1977, prepared in connection with
its attempted note offering, on p. 24 reports actual deficits and the use of Expense Bonds as follows:

(Dollars in Millions)

1976
$ 968 Deficit
654 Expense Bonds
$1,622

1977
$329 Deficit
615 Expense Bonds
$944

1978
$ 718
$ 718

*It may be noted that the zero figure was achieved only by means of nonrecurring revenue and the deferral of maturing debt.

For the years 1979 - 1981 the Special Deputy State Comptroller (Report on Review of the Forecast Expenditures and Revenues for FY 1979 through FY 1981 submitted in the Message of the Mayor dated October 31, 1977) projects a deteriorating situation as follows:

(Dollars in Millions)

1979
$1,113 Deficit
645 Expense Bonds
$1,758

1980
$1,271 Deficit
566 Expense Bonds
$1,837

1981
$1,029 Deficit
489 Expense Bonds
$1,518
Questions concerning the City's financial progress under the corrective programs prescribed for it and its future prospects all revolve around information concerning the amount and nature of the unpaid liabilities carried forward from fiscal years prior to 1975, the results in the two fiscal years completed since then, and trends and authorizations for the year now in progress, which ends June 30, 1978. Unfortunately, there is great confusion in the data which must be used to resolve the question.

One aspect of the situation is the variety of estimates currently reported respecting the prospective operating deficit for 1978-79. Prepared within a matter of weeks of each other by such eminent authorities as the staff of the New York State Comptroller (Deputy Comptroller for the City of New York), the staff of the Municipal Assistance Corporation, the accountants for the General Accounting Office, the U.S. Treasury's supervisory staff, the office of the City's own comptroller, and the office of the City's mayor, these projections differ by significant amounts. Yet they are based on the same original data. Some part of the differences of course represent differing assumptions as to economic conditions which translate into differences in certain revenues or expenses. But most of the differences appear to rest on the basically unsatisfactory body of data with which each must work.
The answer to the question on financial progress, then, must be surrounded with qualifications respecting the data. In general, however, we stated in May and June of this year (in our municipal credit reports dated 5/24/77 and 6/23/77) in which we raised the rating on the general obligation bonds of the City from Caa to B:

The City has made some progress over the past eighteen months. With the aid of a moratorium on note payments which was declared unconstitutional, and Federal financial assistance, it has avoided bankruptcy and endless legal action. Substantial problems remain, but our view is that the City, having coped this far, is in better position to deal with them than it was a year or more ago.

We still hold this view.

* * *

* * *
II

Investor Perceptions

You have asked us to comment on the present perception of New York City by the investment community. We, of course, cannot speak for the investment community. However, the outcome of the attempted note offering by the City in November of this year gives some indication of the investment community's position.

Despite the involvement of two of the largest investment banking/brokerage houses (Merrill Lynch, Pierce, Fenner & Smith, Inc. and The First Boston Corporation) which undertook to form an underwriting group, the City's first attempt at entering the credit market since the fiscal crisis was a failure. The amounts of the short-term notes proposed to be issued were indefinite -- something between $50 million and $200 million or so for each of three note series due respectively on April 15, May 15, and June 15, 1976. It appears to have been recognized that a modest quantity of notes could be underwritten by local houses and placed with local institutions, but such a sale would have no more than local significance. Unless the City was to be restricted to its home-town institutions indefinitely, the participation of the national market was essential. The City itself said: "At present the market for City securities is limited. No assurance can be given that a market for the Notes will develop or that if such a market develops the market prices will be at or near par value." (Preliminary Official Statement dated 11/10/77, p. vi).
It apparently proved impossible to secure national market interest and the sale was abandoned on November 10th. Some press reports singled out Moody's for the failure of the note sale including the New York Times on page 1 of its November 11, 1977 issue with a headline proclaiming "Low Moody's Rating Compels New York to Cancel Note Sale." However, The Daily Bond Buyer of November 14, 1977, page 1, carried a quote of Jean J. Rousseau, managing director of the Municipal Bond Department of Merrill Lynch, Pierce, Fenner & Smith, Inc. stating: "Mr. Rousseau said the withdrawal decision was not based on the rating but rather on a number of problems which had arisen. He declined to elaborate, only adding philosophically, that 'in a few snowballs you'll find a rock'."

We can only conjecture as to why the general response to the proposed offering was so negligible although the City itself in its Preliminary Official Statement dated 11/10/77 cited numerous quantifiable risks associated with its securities. The Preliminary Official Statement contained a section entitled "Summary of Certain Risk Factors" (p. ii). This section enumerated eleven risk factors and ran six pages. The Preliminary Official Statement noted, however, that "this is only a very brief and general summary of certain types of considerations which should be evaluated" (p. iii). One overriding risk, it seemed to us, was the startling fact relating to all the City financial statements that "the City can give no assurance that the statements are free of material errors or omissions" (p. iii). The Cash Flow Statements for 1977 and 1978 were introduced with the comment: "All actual amounts are unaudited and subject to potentially material revision or adjustment" (p. iii). The same point was emphasized in the
Preliminary Official Statement where it advised that "it is possible that material errors or omissions may exist in the City Financial Statements and in other financial data set forth herein" (p. 17). The explanation given was that the new accounting system "is very complex and it is reasonable to expect that some time will elapse before all elements are functioning smoothly" (p. iii).

An additional major risk specified by the Preliminary Official Statement was the ease with which the City may invoke Federal and State bankruptcy laws. The City Preliminary Official Statement states:

From time to time, since the beginning of the City's fiscal crisis, there has been discussion of whether or not the City would seek protection under Federal and State bankruptcy, insolvency or other similar laws affecting creditors' rights. (p. ii).

The City Statement continues to emphasize the extreme uncertainty for noteholders if the City sought, or were placed under, the "protection" of such laws:

In the event the City were placed under the protection of such laws, either on its own petition or that of the New York State Emergency Financial Control Board (the "Control Board"), neither Bond Counsel, the Corporation Counsel, Special Counsel to the City or Counsel for the Underwriters is prepared to render opinions relating to the priority of claims by the holders of the Notes, and serious doubt exists whether the Revenues would not be available for other creditors including holders of faith and credit obligations. (p. ii).

Plainly, prospective purchasers, with many alternative investment opportunities, are repelled by the environment described in the City's Statement. Indeed, the Control Board would not give a proposed assurance to investors that it considered bankruptcy "unlikely". (Compare Preliminary Official Statement, proof of
November 7, 1977 at p. ii with proof of November 8, 1977 at p. iii.

The Prospectus observed that the State was not legally
obligated to pay the education aid pledged to the noteholders as
security, and further, that the State would not be able to make pay-
ment unless its Spring borrowing was successful. It noted: "the
State Legislature is not legally obligated to appropriate such
amounts, and there can be no assurance that the State Legislature
will in fact do so" (p. ii). Any further, "payment of the Revenues
will be dependent upon the success of that borrowing by the State
under market conditions then existing" (p. iii).

Another potential risk cited, with reference to continued

Federal Loans, stated:

Although the City expects to continue to be dependent on
substantial seasonal loans from the Federal Government in its
1979 fiscal year, it should be noted that the statutory author-
ization for such loans expires on June 30, 1978. The City
anticipates that legislation seeking an extension of this
authority will be introduced in Congress but it can give no
assurance that such statutory extension will be enacted.
(p. iv-v)

In addition, the City's November Preliminary Official Statement
raised serious questions as to the continued use and legality of

Expense Bonds. The statement reads:

Bond Counsel retained by the City in connection with the
sale of notes and bonds to the Pension Funds has questioned
whether bonds can be sold to finance certain operating
expenses included in the Capital Budget already incurred and
to be incurred. The City does not believe that this will
affect the projected sale of bonds to the Pension Funds in
its 1976 fiscal year. See "Financial Plan -- Assumptions".
The inability of bond counsel to approve the issuance of City
bonds to finance certain operating expenses could, however,
create severe financing problems in subsequent years. (p. iv.)
Since, in subsequent years, the City has intended to issue some $2.5 - $3.0 billion of Expense Bonds its inability to do so would be a major problem. On the other hand, and demonstrating the precarious position of the City, the continued sale of Expense Bonds to the pension funds also entails severe problems. MAC Chairman, Felix Rohatyn recently was quoted as saying: "I'm convinced we can't do long-term financing until the problem is solved." (Wall Street Journal, 11/28/77.)

The City Preliminary Official Statement also made clear that "the City remains dependent on the continuation of the State's practice of advancing State aid payments due the City" (p. iv). Further, the "City has relied in part upon the $800 million" State advance in order "to repay loans under the Federal Credit Agreement" (p. 20). The process has been described as a "fiscal shell game" by Comptroller Goldin (Wall Street Journal, 11/28/77) in which (1) the City borrows the State advance to repay the Federal Government and (2) then borrows from the Federal Government to repay the State advance. This process is hardly an example of fiscal strength and does not inspire investor confidence. Taking all these factors into consideration, it was not surprising to read in the Wall Street Journal editorial of 11/21/77 that Felix Rohatyn, the City's top financial advisor, gave a speech two weeks ago in which he labeled the pending note offering as 'a triumph of form over substance'.
The underwriters requested a rating on the notes from Moody's. The considerations central to our decisions in arriving at a rating are designed to serve the interests of the investors who subscribe to our services. The questions we raise are the questions to which we think investors need answers.

Our evaluation of the City's attempted note sale revolved around the two main aspects of security pledged to the noteholder. The first was the broad pledge of the issuer, that the notes constituted valid and legally binding general obligations of the City and that, in the opinion of bond counsel, all taxable property within the City would be subject to the levy of unlimited ad valorem taxes to pay the notes. The second layer of security provided by special legislation was the mechanism prescribing the State of New York to lend, not its credit, but its assurances, however qualified, that the money pledged for the repayment of the notes would be transferred directly from the State to the paying agent, completely bypassing the City. Our municipal credit report dated November 10, 1977 on the proposed sale describes in detail the factors leading to our conclusion. It was our opinion that the first broad pledge of the issuer had to be appraised as a weak one since recent debt history and current financial uncertainties were of overriding significance. It was only by placing emphasis on the mechanism provided through the passage of special State legislation that we felt we were able to put an investment grade rating on the revenue anticipation notes.

We assigned our lowest note rating, Baa 3, to the City’s proposed offering. Our analytical process began with five options:
the ratings of MIG 1, MIG 2, MIG 3, MIG 4 and no rating at all.
The amendments enacted by the State legislature, effective October
26, 1977, to the Local Finance Law and the State Finance Law pro-
viding for the payment of the notes from State education aid
normally due the City and providing for the transfer of that
aid directly from the State Comptroller to the paying agent gave
us assurance in their structure and likely application and bridged
the gap from non-investment grade to a note rating. Looking to
any additional security elements provided, we found few. Not
only did some uncertainties exist concerning the State and the
availability of the State education aid pledged, but many areas
remained unclarified concerning the issuer itself. We drew virtually
no assurance from the issuer and apparently neither, as will be
explained below, did any of the other major parties involved in the
offering including the State, the underwriters and certain City
officials.

The City had promised, under the Federal Credit Agreement, to
make an attempt to re-enter the public credit market before June
30, 1978. Given the final structure of the note offering, it appears
to have been the opinion of all major parties concerned that the City
could not make a viable attempt at re-entry on its own credit alone.
Therefore, a debt instrument was tailored for the occasion, by
which the City could at the very least make a respectable bid for
public acceptance. It would appear that the State's recognition
of this situation was reflected in both the speed with which special
legislation was adopted by the legislature and the close involvement
of its chief fiscal officer in the payment of the notes. The legisla-
tion was worded such that the State did not expressly lend its credit
but by acting as the originator and conduit for the funds pledged
to the noteholder, provided the primary security for the notes.
By keeping the pledged funds out of the City's hands, the legislation
added an appearance of safety, as the issuer at the time was not
perceived as having the image of a prudent fiscal entity.

From the documentation received in connection with the note
offering and the meetings and conversations which were held with
the underwriters, City officials and others prior to the assignment
of our rating, the emphasis on security for the note holders was
stressed as being provided by the State's involvement in the payment
process. The funds for the payment of the notes would bypass the
City completely. This built in recognition of the weakness of New
York City probably best categorizes the investment community's per-
ception of it as a financial entity.

Yet another disturbing situation that existed at the time of
our analysis was the fact, and it was a fact, that the City remained
in default on other short-term obligations. There were stated plans
to remedy this, variously stated to occur by the end of November
or the end of December, 1977, but not prior to the sale of the new
notes. Although there was a court order which called for the payment
of these now commonly known "moratorium notes" by the year's end
(after having been in default for nearly two years), the issuer
apparently did not see this as creating any obstacles to gaining
renewed market acceptance of similarly structured obligations. The
City, which had made dubious promises to security holders in the
recent past, now believed that with little or no redress of past mistakes it could make new promises and be believed. We think the investment community has a long memory on failure to pay obligations and recovery has to be strong and decisive to be acceptable.

Other negative factors taken into consideration in the City's position related to expiration of certain labor contracts during the maturity of the notes and the generally unsatisfactory condition of the City's finances, as detailed elsewhere in this testimony. Of great concern was the continued existence of Title 6-A of the New York Local Finance Law which provides for the stay of actions or proceedings seeking enforcement of City bonds, notes and other obligations upon the filing in the State Supreme Court by the City or the Control Board of a petition which states the City is unable to pay its debts as they mature. Title 6-A also provides that no action or proceeding may be brought against the City or any of its property or revenues involving the breach of any bond, note or other obligation unless payment is due or overdue and 30 days have elapsed since demand for payment. This legislation was added to the books of the State as part of the financial emergency legislation adopted on September 9, 1975, as the New York City fiscal crisis gathered momentum. Not only did the legislation remain in effect State-wide, but the City could give us no legally binding pledge that Title 6-A would not be used as a recourse during the maturity of the notes. This very action had been taken by another financially troubled municipality in the State at the time it attempted, successfully, to re-establish its credit standing in the marketplace. The continuing availability of this
statute to as financially vulnerable an entity as New York City created very serious doubts in our minds. This, together with an amended and much simplified Federal Bankruptcy Act for municipalities and given the moratorium legislation earlier adopted for the City, caused us great concern about any pledges made by the issuer of the notes.

Any uncertainty detracts from the quality of an investment. With all the uncertainties present at the time of our analysis, a high quality rating of the proposed note offering was almost automatically precluded. The City faced (and faces) the following pressures in the immediate future: the end of the Federal Seasonal Loan Program, the end of the municipal pension funds' commitment to purchase city bonds, the end of the Emergency Financial Control Board, union contract negotiations and settlements not budgeted for, uncertainties as to MAC borrowing authorizations and its continued effectiveness in providing financing, and, most importantly, continued unbalanced and projected worsening financial operations. Our definition of the MIO 4 rating begins "Loans bearing this designation are of adequate quality...". To have been able to make a more positive characterization of the City's short-term position was not possible.

The New York Times (11/15/77) editorialized: "But the City's short-term notes had in fact developed a tendency to become long-term debt through constant roll-over at their maturity. Moody's could well expect the same to happen again with the proposed issue and so the long-term prospect could not be ignored."

* * *
APPENDIX I

When experts with large auditing staff and the right to inspect the ledgers have such apparent difficulties in determining the facts, outsiders such as investors, credit analysts, and the general public can find little reassurance in the data available. In fact, such data are themselves highly contradictory.

Prospects for 1977-1978

As of the end of calendar 1975, the plan for 1977-78 projected current revenues available of $12,711 million and the use of $555 million of serial bond proceeds to finance current expenses. This total estimated to be available of $13,266 million fell short at that time by $493 million of covering projected expense requirements of $13,761 million. The "gap" was considerably enlarged before the required reductions in expense projections were made. In the end, expenses were not reduced, but rather revenues increased. The amount of bonding of current expenses has also been increased:

<table>
<thead>
<tr>
<th>(Dollars in Millions)</th>
<th>Plan as of 12/31/75</th>
<th>Forecast as of 10/31/77</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Revenues</td>
<td>$ 12,711</td>
<td>$ 13,482</td>
</tr>
<tr>
<td>Bonds for Expenses</td>
<td>555</td>
<td></td>
</tr>
<tr>
<td>Total Available</td>
<td>$ 13,266</td>
<td>$ 14,200</td>
</tr>
<tr>
<td>Expenditures</td>
<td>$ 13,761</td>
<td>$ 14,059</td>
</tr>
<tr>
<td>Deficiency for year</td>
<td>$ 493</td>
<td>$ ---</td>
</tr>
<tr>
<td>Reserve for year</td>
<td>$ ---</td>
<td>$ 151</td>
</tr>
</tbody>
</table>

The forecast indicates that 1977-78 operations of the City will be "balanced" in the terms of the emergency finance law and the plan for the year. They will not be balanced, of course, in the meaning of that term as used generally in governmental finance. The forecast indicates that expenditures will be $577 million in excess of current revenues ($773 million funding bond proceeds less $141 million unexpended and designated as a reserve for the year).

In addition, financing assumed for the year includes such questioned items as deferred JAC debt service, the inclusion in the capital budget of maintenance...
costs usually expensed, anticipation of one-time revenues (such as claims against the Dept. of HSH and Penn Central tax settlements), and the use of proceeds from the sale of housing program mortgages which still have not materialized.

It also appears that some state and federal aid items have been over-estimated (such as extension of Federal counter-cyclical aid after September 30, 1976, increased Federal welfare aid and increased State assumption of CUNT costs and the court system). Whether these deviations will be absorbed by the $141 million of forecasted reserves for 1977-78 remains to be seen.

Individual month and year-to-date figures as given in the City's monthly reports to the Secretary of the Treasury indicate some deviations from the plan. The bulk of these are described as due to timing rather than either a loss of prospective revenues or expenditures in excess of contemplated levels. For the four months, federal and state aid received ran some $494 million under the plan projections, for example, but the City states that substantially the totals planned for the entire year are still prospective.

The deviations from plan versus the first four months of 1977-78, if not in fact due primarily to timing changes, could be substantial on an annualized basis. The four months compare as follows with the first four months of the preceding year. Both sets of data are from the reports to the Secretary of the Treasury.

<table>
<thead>
<tr>
<th></th>
<th>1976-77</th>
<th>1977-78</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real Estate Taxes</td>
<td>$1,434</td>
<td>$1,413</td>
</tr>
<tr>
<td>Federal Aid</td>
<td>625</td>
<td>375</td>
</tr>
<tr>
<td>State Aid</td>
<td>370</td>
<td>1,000</td>
</tr>
<tr>
<td>Other</td>
<td>2,205</td>
<td>1,382</td>
</tr>
<tr>
<td>Current Revenues</td>
<td>$3,510</td>
<td>$4,170</td>
</tr>
<tr>
<td>Expense Bonds issued</td>
<td>138</td>
<td>---</td>
</tr>
<tr>
<td></td>
<td>$5,698</td>
<td>$4,170</td>
</tr>
<tr>
<td>Expenditures:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>City Debt Service</td>
<td>$554</td>
<td>$492</td>
</tr>
<tr>
<td>MNC Debt Service</td>
<td>197</td>
<td>37</td>
</tr>
<tr>
<td>Personal Services</td>
<td>1,132</td>
<td>1,500</td>
</tr>
<tr>
<td>Other than Personal Services</td>
<td>2,316</td>
<td>2,924</td>
</tr>
<tr>
<td></td>
<td>$4,200</td>
<td>$4,853</td>
</tr>
<tr>
<td>Deficiency</td>
<td>$412</td>
<td>$663</td>
</tr>
</tbody>
</table>
Prospects for 1978-79 and beyond

The budget-making process is rendered especially uncertain at this time because of questions concerning whether the City's finances will continue subject to the supervision of the Emergency Financial Control Board or of some other as yet undetermined agency. In any event, initiation of the budget and plan for 1978-79 and the immediately succeeding years will be the prerogative of the new mayor, who takes office January 1, 1978. Mr. Beame himself has stated, New York Times, 11/22/77, "...that the numbers were still in flux and would change again before the next fiscal year begins July 1st."

The outgoing mayor submitted a plan for 1978-79 to the Control Board in November, indicating a budget gap of $249 million after proposed deficit funding bond issuance of $655 million - a total imbalance of some $904 million. The mayor's estimates compare as follows with the latest figures for 1977-78:

<table>
<thead>
<tr>
<th></th>
<th>1977-78 Forecast</th>
<th>Mayor's &quot;Plan&quot; 1978-79</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Oct. 1977</td>
<td>Nov. 1977</td>
</tr>
<tr>
<td>Current Revenues</td>
<td>$13,482</td>
<td>$13,244</td>
</tr>
<tr>
<td>Bonds for Expenses</td>
<td>718</td>
<td>655</td>
</tr>
<tr>
<td>Total Available</td>
<td>$14,200</td>
<td>$13,699</td>
</tr>
<tr>
<td>Expenditures</td>
<td>$14,059</td>
<td>$14,148</td>
</tr>
<tr>
<td>Deficit</td>
<td></td>
<td>249</td>
</tr>
<tr>
<td>Unexpended</td>
<td>141</td>
<td></td>
</tr>
</tbody>
</table>

The $249 million represents 1.8% of the projected expenditure total for 1978-79. However, the Special Deputy State Comptroller of the Emergency Control Board under the emergency finance law, forecasts considerably larger gaps between revenues and expenditures:

- Mayor's estimated budget gap for 1978-79: $249 Million
- Minimum additional deficit estimated by Special Deputy State Comptroller as of 12/11/77: $119
- Add cost of living adjustments at 1978 rate: $119
- Or 6% wage increase: $205
- Or cuts in major taxes—decrease gap by: $50 — $155
All projections cited, whether the incumbent mayor's or the special comptroller's, are potentially subject to change by the new administration.

It is perhaps notable that the present mayor's "plan" for 1978-79 provides for expenditures other than debt service some 2% greater than such actual expenditures for 1974-75, as determined by Arthur Anderson & Company in their study of June 23, 1976 for the Secretary of the Treasury. It is interesting also that the present mayor's estimates of current revenues (i.e., revenues excluding borrowing for expenses) is some 1% greater than the Arthur Anderson findings of actual expenditures for operations and debt service combined in 1974-75.

<table>
<thead>
<tr>
<th>(Dollars in Millions)</th>
<th>1974-75 Actual</th>
<th>1977-78</th>
<th>Mayor's Plan</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>per Arthur Anderson</td>
<td>Forecast</td>
<td>10/77 Plan</td>
</tr>
<tr>
<td>Expenditures:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>City Debt Service</td>
<td>$ 1,627</td>
<td>1,667</td>
<td>1,480</td>
</tr>
<tr>
<td>MMG Debt Service</td>
<td></td>
<td>440</td>
<td>501</td>
</tr>
<tr>
<td>All Other</td>
<td>9,807</td>
<td>11,292</td>
<td>12,167</td>
</tr>
<tr>
<td></td>
<td>$11,714</td>
<td>$14,559</td>
<td>$14,246</td>
</tr>
<tr>
<td>Revenues:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real Estate Taxes</td>
<td>$ 2,649</td>
<td>3,168</td>
<td>3,155</td>
</tr>
<tr>
<td>State &amp; Federal Aid</td>
<td>a</td>
<td>5,107</td>
<td>5,282</td>
</tr>
<tr>
<td>All Other</td>
<td></td>
<td>3,286</td>
<td>4,807</td>
</tr>
<tr>
<td>Current Revenues</td>
<td>$15,718</td>
<td>$13,487</td>
<td>$13,264</td>
</tr>
<tr>
<td>Funding Bonds</td>
<td>N.B.</td>
<td>718</td>
<td>655</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$14,200</td>
<td>$13,899</td>
</tr>
<tr>
<td>Deficiency</td>
<td>-</td>
<td>-</td>
<td>249</td>
</tr>
<tr>
<td>Unappropriated Reserve</td>
<td></td>
<td>141</td>
<td>-</td>
</tr>
</tbody>
</table>

a. Breakdown not available; total for the two items $8,069,000.

For years beyond 1978-79, present estimates are even less satisfactory.

Further, until the new City administration has indicated by its budget submissions for 1978-79, its policies as reflected in labor negotiations in the forepart of 1978, and other likely indicators of its objectives and priorities, there will be little basis for projections by outsiders.
Prospects for Market Re-Entry

You have asked us what is required for the City to return to the market and when this may occur. We have elsewhere in this testimony indicated the magnitude and complexity of the problems facing the City. In practical terms, we see little distinction to be made by the market for acceptance of short-term loans or long-term bonds. The achievements which will re-open the market for short-term notes should simultaneously re-open the market for long-term bonds.

We do not serve as consultants and do not recommend courses of action to those we rate. Improving the ratings on the City's obligations, however, will require a number of steps on the part of the City. Probably the same steps will have to be taken to convince a substantial number of investors to take interest in the City's bonds and notes as investments. Among these steps are the following:

1. creation by State law of separate funds to receive and disburse the moneys levied for interest and serial bond and note principal;
2. repeal by the State Legislature of Title 6-A to the Local Finance Law;
3. withdrawal by the State of New York of consent to the filing by local units of petitions under Chapter IX of the Federal Bankruptcy Law;
4. assurance of the continuation of a fiscal monitor;
5. clarification of the status of MAC's authorizations and responsibilities;
6. elimination of the annual roll-over of the State advance;
7. clarification of the municipal pension/sinking funds' future bond purchasing role;
8. more rapid phase-out of the use of bonds to finance current expenses;
9. correction of the long-standing imbalance between the expenditures required of the City by the State and the revenue system provided for the City by the State.
10. Reform of the long-standing budgetary inadequacies.

Under the 1975 law, the City is given ten years to eliminate current expense borrowing; without acceleration, operations will not be balanced, as that term is normally understood, before 1987.

Unless the use of bonds to finance current expenses is phased out faster than is presently contemplated, a date for market re-entry would not be expected before that date.

* * *

* * *
Conclusion

Our confidence in the City's ability to pay its note obligations was mostly based on the State's role in the financing plan. The City, we feel, has drawn back from the immediate threat of bankruptcy, but this prospect has not been eliminated and will in fact intensify in its likelihood in coming months, depending on what actions are taken or not taken.

We feel that both the problems and the solutions are too often oversimplified. We suggest that the City's problems go far deeper than accounting, that its failings have been far more serious than merely making overly generous settlements with its unions. The City has disregarded the sound precepts of public administration and has violated the most elementary rules for maintaining fiscal solvency. The progress that the City has made over the past two and one-half years is almost wholly attributable to the oversight and management functions which have been performed by the Control Board, MAC, the Treasury and the Congress. Its affairs are now being conducted in a more orderly manner. However, until the long-term problems are truly addressed, there will be no realistic prospects of the City becoming once again self-sufficient on a continuing basis.

* * *
Chairman Moorhead, Mr. Beason.

STATEMENT OF AMOS T. BEASON, SENIOR VICE PRESIDENT, MORGAN GUARANTY TRUST CO. OF NEW YORK

Mr. Beason, Mr. Chairman, members of the subcommittee, and Mayor-elect Koch:

My name is Amos T. Beason. I am a senior vice president of Morgan Guaranty Trust Co., of New York, and have responsibility for the bank's activities as a underwriter of and dealer in securities issued by States and their political subdivisions and for its activities as a financial adviser to public bodies.

I welcome the opportunity to come before this subcommittee and discuss the financial situation of New York City.

The subcommittee's interest in assessing the City's progress toward working out a permanent solution to its financial problems, and in determining the role of Federal assistance in enabling the City to do so, is shared, as you know, by your colleagues in the Senate. Today Elmore C. Patterson, chairman of the board of Morgan Guaranty, is presenting our bank's views on essentially the same subject before the Senate Committee on Banking, Housing, and Urban Affairs in Washington.

The subcommittee's list of items asked first about the City's progress toward fiscal and financial stability. We can state that there has been progress since the Congress' passage of the New York City seasonal loan legislation of 1975, not as much as any of us concerned with the City's problems had hoped, but progress nonetheless.

In particular, the City government has made important strides in its financial controls. It has set up improved mechanisms of budgetary control and procedures for financial reporting. An independent public accounting firm has been retained to conduct an audit of the City's financial statements for the current fiscal year. Monthly financial reports are being monitored by the U.S. Treasury Department. The workability of an oversight mechanism, in the form of the Emergency Financial Control Board, has been demonstrated.

The significance of these developments should not be obscured by the failure of the note issue which was attempted last month. The fact that the City, despite the best efforts of its officials and the underwriting group, could not reenter the market means simply that progress, while substantial, has not yet gone far enough.

Even if the note issue had succeeded, it would not have meant that New York had regained the ability to finance itself in the public market. An offering of short-term notes, bolstered by the participation of the Federal Government as a coender, was not a test which could have rendered that finding. We do not criticize the idea of attempting the issue. Indeed, the bank I represent participated in the attempt. I simply wish to make clear that we do not regard the way the effort turned out as a severe setback to New York's recovery.

We continue to believe, as we have all along, that reentry to the market is essential to the financial rehabilitation of the City. That reentry, however, must be accomplished on the City's own merits, demon-
strated to the satisfaction of investors who presently are cynical and suspicious.

We believe that this can be done. There probably are a number of ways to do it; but the best way, in our judgment, is the hard way—namely, by the City's demonstrating an ability to meet its capital needs by selling long-term bonds in the public market. If it does the things that will be necessary to regain that degree of investor acceptance, then its standing in the investment market will be such that seasonal financing needs can also be met.

We do not minimize the difficulty of the steps that will have to be taken, or the time they will require. We believe it is possible to set out quite specifically a number of conditions the City must meet in order to be able to sell long-term bonds. One condition, in our judgment, is the continued acceptance by the City of an effective financial control mechanism. A monitor of its fiscal conduct is necessary until the City is able through a series of balanced financial operations to give investors a sense of assurance that the problems of the past will not be repeated.

The concept of a control mechanism was for a while one of the most controversial elements in discussion of the City's financial future. Acceptance of the concept has gradually grown, however, and experience with the Emergency Financial Control Board has shown that the City can function under restraint.

A second requirement is to give investors a further assurance of the first claim which bond principal and interest have on the City's property tax revenues. That claim should be reinforced by State legislation providing that the revenues go directly to a trusteed escrow account in an amount sufficient to meet the debt-service needs. This would benefit both present and future City bondholders by easing an uncertainty which developed during the crisis of 1975 and which has clouded the market ever since, even though there has been no interruption of debt service on the City's outstanding bonds.

I note that Congressman Caputo is sitting here. Congressman Caputo's district in Yonkers has done that, and they did regain access to the market. Another requisite for reentry to the long-term market is accelerating the removal of current operating expenses from the City's capital budget which were allowed to be there by permissive State legislation. State law would let the removal process drag on until fiscal 1986, but rehabilitation of the City's credit suggests a deadline at least 5 years sooner, with a sizable chunk of the total being taken in fiscal 1979. The Secretary of the Treasury has specified that an acceleration should be a condition of further Federal assistance, and we agree with that view.

Indications are that in the current fiscal year the City expects to live within its operating budget, which, of course, was balanced largely by the funding of some $600 million of current operating expenses in the capital budget. For fiscal 1979, there have been estimates that a gap of as much as $400 to $500 million will have to be closed during the budgetmaking process in order to achieve balance, and those estimates are said to make no allowance for any new costs that might be incurred as a result of labor negotiations that are pending. Nor does the esti-
mulate of the fiscal 1979 deficit take account of any accelerated removal of operating expenses from the capital budget.

We do not have a basis for evaluating those estimates, but it is obvious that achieving balance in the coming fiscal year is going to be a very difficult task—especially if substantial progress is to be made in taking operating expenses out of the capital budget. Preparation of a balanced expense budget for fiscal 1979 is going to be a crucial test for the new City administration. It will obviously have to make some hard decisions.

Essential services must by definition be maintained; otherwise, we simply don’t have a City. Also, the new administration and the State are going to have to continue efforts already in progress for other levels of government to share more equitably the cost of certain of the City’s social programs.

Except for these basic observations, it is our view that questions about how to balance the budget are public policy questions which must be decided by elected officials. We would stress again, however, that nothing is more critically important to the fiscal future of the City than the ability to produce, and live within, expense budgets that are genuinely balanced.

Thus far, in listing requirements that must be met for New York to regain access to the long-term bond market, we have concentrated mainly on things the City itself must do. Outside help will continue to be needed, although its precise form cannot be determined until the City issues its fiscal 1979 budget. Still, we see no way for the City to make it without the continued help of credit facilities from the Federal Government. This outside credit assistance will be needed to give the City a chance to demonstrate that it can reestablish its access to the bond market.

We are not happy to have to urge the prolongation of Federal involvement as a lender to the City. The size and complexity of the City’s financial problems, however, make it imperative that more time be allowed for the City and the State to work out the solutions.

Besides continued access to Federal credit, the City is going to need further help from New York State’s Municipal Assistance Corporation. The goal of any financial assistance from the Municipal Assistance Corporation as well as from the Federal Government should, of course, be to restore New York City as its own financing entity.

The subcommittee’s list of topics for these hearings asked when it is likely that the City can return to the market. The setting of a timetable requires greater gifts of foresight than we can muster. It would require certainty about such matters as the programs of the new mayor and his administration, the outcome of negotiations with municipal labor unions, the interaction on New York City of a variety of economic and social forces, and actions taken on the State and Federal levels, including those by the Congress in providing continued Federal financing assistance to the City. We do believe that it lies within the power of City officials to make a market reentry sooner rather than later by making continuously visible their commitment to restoring investor confidence in New York’s fiscal integrity.

This concludes my statement. I would like to thank the chairman and the members of the subcommittee for this opportunity to express our views.
Chairman Moorhead. Thank you very much, Mr. Beason. Thank all of you.

I am going to ask one specific question, and then maybe if we have time, a general question.

I think probably all of you are familiar with Mr. Rohatyn's proposal of a long-term Federal loan which is to be "backed by City long-term bonds."

Now my question to you is: What kind of security would this be? Would this in effect be an unsecured loan by the Federal Government?

Anyone of you who want to, answer it.

Mr. Harnes, I am sorry, just one clarification. Doesn't it call for the purchase of MAC bonds by the Federal Government?

Chairman Moorhead. Yes, secured by City bonds. But what I am saying is, is there any real security there? Isn't it, in effect, an unsecured loan?

Mr. Harnes. I think to some extent it is. But I think what Mr. Rohatyn—and I can't read his mind—but what he may be thinking about is the fact that if these bonds are purchased, it will provide access to the market for other bonds of the City of New York because it will get this expense budget question out of the way, probably the State advance out of the way, and it will thereby enable the City to go—which we have all testified to—to the market for its own capital needs. If the market is reestablished for City bonds, the bonds that the Federal Government owns should be worth more, because if the City is back in the market, the Federal Government will have bought the first bonds, probably at the highest interest rate. And thereby, the Federal Government's bonds will be worth the most. And I think he projects that at some point the Federal Government would have quite a profit in these bonds.

But I don't think they are completely unsecured. I think MAC has a revenue flow, but they are not guaranteed, no.

Chairman Moorhead. Then let me ask you gentlemen, as Federal taxpayers, as all of you and all of us are, do you favor Mr. Rohatyn's proposal, or what form of Federal assistance would you recommend?

Mr. Harnes. I personally don't favor Mr. Rohatyn's proposal, because as a taxpayer I think it runs out much too long. It keeps the Federal Government involved with New York City over much too long a period in order to force New York City to do some of the things that it has done so well in the last 2 years.

I would be less than candid if I told you that I had looked at all of the ramifications of what Mr. Rohatyn wishes to see adopted, but his greatest point, which he made very clearly this morning, is that as a financial adviser, he is trying to shift the City's debt into a long-term payout, which obviously would lower the tremendous yearly payments which the City must meet for debt service now; and in stretching it out would lower those amounts.

I prefer to look—and if I were in your position—at a continuation of the Federal loan. I originally testified—

Chairman Moorhead. Continuation of the seasonal loan?

Mr. Harnes. Continuation of the seasonal loan. I originally testified 2 years ago that it should be in the range of 5 to 8 years, not the shorter loan that finally was put into effect. I would possibly lean now to a
phasing down of the amount of the loan with specific target dates each year, which I think would provide a greater stimulus and the kind of stimulus that is needed for New York City to continue to do the types of things it has done in the last 2 years.

Chairman Moorhead. Your testimony, then, is that you would recommend to this subcommittee a continuation of the seasonal loan program for a period of, say 5 years, with scheduled phasdown?

Mr. Harris. Yes, sir.

Chairman Moorhead. Rather than the long-term solution in some form or another?

Mr. Harris. I continue to personally think Mr. Rohatyn’s plan is simply too long to force some of the continuing needed restraints and constraints that the City and State must employ.

Chairman Moorhead. Do any other members of the panel want to comment?

Mr. Phillips. Well, I haven’t evaluated Mr. Rohatyn’s plan, but I think that while there are recommendations implicit in the testimony that I gave, I think it is implicit that we feel that the City has been very badly hurt by this experience, and that it does need some more time. And I do think that in evaluating its note offering, while the Federal seasonal loan extends over the period those notes would have been outstanding, nevertheless, the problem of short-term financing of the City is an urgent one.

Chairman Moorhead. Thank you. Mr. McKinney?

Mr. McKinney. Thank you very much, gentlemen, for coming.

I have a very hard time now, Mr. Harris, as I did 2 years ago, overcoming my feeling that the City of New York can resolve its problems any sooner than a minimum of 10 years.

I was somewhat surprised by your emphasis on a shorter period of time. Wouldn’t it be possible to put the same constraints on the management of the City even under a longer period? That is if the Treasury insisted and demanded the proper participation on a State and Federal basis.

Mr. Harris. Mr. McKinney, let me get the period of time in perspective; my range was 5 to 8. We are a little bit closer together on the long end.

I felt 2 years ago, and I continue to feel today, that the Federal loan should not be made directly to the City; that the Federal loan should be made through the State or State agency, so as to impose upon the State a uniform series of requirements to keep itself viable, and therefore get rid of some of the political infighting that takes place in New York between the upstate legislators and the so-called downstate legislators.

With that type of mechanism in place, I truly feel that, given any kind of break in the economy, the City can make rapid strides toward getting out from under this debt and eventually, as it starts to retap the market, lengthen its debt itself. New York City has long operated with a terribly short maturity schedule. At the time when the City went under, you may recall—or not went under, but in the middle of 1975—the average life of New York City debt was just in excess of 8 years, which is very short for an entity that has $11 billion in debt outstanding.
Mr. Beason. Mr. McKinney, the City of New York collects $3 billion in property tax each year. The debt service on its general obligation bonds now outstanding for fiscal 1979 is expected, or scheduled, to be in the amount of about $1.4 billion. If an investor believed that the property tax was going to go to him before it went to run the essential City services, and he had some feeling that there was a commitment here, I would think that that would give him some reason to want to hold long-term New York City bonds.

Mr. Horowitz. I think that just as—Mr. Harries is talking about 8 years. I don’t think that 8 years or 20 years is the factor if the City is going to make it. And I would assume that any kind of bond that they sold to the Federal Government, or that MAC sold to the Federal Government—and that would also take care of Mr. Harries’ concern because it would be sold through a State agency—would probably have some sort of call provision. If the City makes it, they are going to get rid of these high-risk bonds. If they don’t make it, somebody’s going to have to be there doing something. So I think it is so much semantics, the length of the loan.

Mr. McKinney. Well, in the original bill that the subcommittee came forth with, we had a requirement not that the money be loaned to the State, but we had a requirement that the State trigger the loaning mechanism from the Treasury, and until the State said, “Do it,” it would not be done, which would relieve some of the political problems.

I have two technical questions which I would like an opinion on.

The press recently has been extremely critical of IFMS and where it’s going. I would like your opinion on that.

And then I think a basic underlying question involves whether or not the necessity for a direct loan exists. It would appear to me that the loan guarantee route, which Congress passed for the Lockheed Aircraft Co., would do just as good a job.

Mr. Horowitz. On IFMS, I am certainly not qualified. I hope—I heard the mayor-elect speak before that this is going to be one of the things that next year, when he develops a program based on all of the concerns and problems, that this is one of the things that he will investigate. And I have no way of knowing the effect of IFMS.

The Federal guarantee raises a question, I think, outside the purview of the City of New York, also. It raises a question, I think, involving the whole concept of tax exemption, which I haven’t got the time to go into now.

But if you are going to guarantee the securities of the City of New York, why shouldn’t you guarantee the securities of just about every State and city in the United States? I can see making a loan that the City has to repay, but I don’t see why any of your States or municipalities should not be able to use the lower interest rate which would be attained by Federal guarantee.

Now, if you are going to say in the obverse that if you put a Federal guarantee on, you are going to have the bonds sold as taxable bonds, I think you would raise quite a problem for your own taxable market, including the U.S. Government market, and the other corporate market. It is not a question which you can resolve just in the context of New York City.
Mr. HARRIES. Yes; I agree with the second part of Mr. Horowitz' statement. A guaranteed bond, even guaranteed by the Federal Government, never sells at the same rate as a Federal Government loan itself; and I think you get into horrendous problems.

I thought the Federal Government could not provide a break for the City, but in effect, permit the City to borrow at a reasonable cost, which would not cost the Federal Government; which, in effect, would make money for the Federal Government; which it has, which has been noted in the testimony this morning.

I will pass on the IFMS question, if I might.

Mr. PHILLIPS. The IFMS question is one to which I don't have an answer, because I haven't seen that much of IFMS, nor what it is supposed to do, nor what it does, and that sort of thing. We are still waiting for it.

The loan guarantee, I think, is a very complex question. The reasons for opposition to it seem to me to be beyond the immediate subject, but whether this should be brought in for New York City is itself a big question. I am not sure that even this would trigger an affirmative response.

Chairman Moorhead. Mr. Badillo?

Mr. BADILLO. No questions, Mr. Chairman.

Chairman Moorhead. Mr. Vento?

Mr. VENTO. Mr. Harrizes and Mr. Phillips have also referred to the fact that New York City in the past fiscal year spent more money and consequently had to issue bonds for the funding of current expenditures, or refunding.

But isn't it true that part of the money that was spent went to pay off short-term bonded debt and for bond debt service? Isn't that considered by the market, or experts like yourselves, when you look at that issue? I mean, they have reduced their total capital when they pay off some short-term bonded debt in terms of the balance; isn't that more of a positive than a negative?

Mr. HARRIES. Mr. Vento, let me say first that Standard & Poor's Corp. never rated New York City's short-term notes, its short-term debt in any way. We never recommended the sale, we never recommended the purchase of it, contrary to any remarks made in the SEC staff report on transactions in New York City, which are erroneous.

Now, as to New York City meeting its bonded debt, we felt all along that it would. We suspended our rating on the bonds on April 1, 1975, because we saw the City in a severe cash-flow crisis.

Now the City has met bonded principal and interest on the 1st and 15th of every month in every year since then and continues to do so. New York City's bonds come due on the 1st and the 15th of every month of the year, all year long.

And I would point out that investors also see that those bonds are being paid because those are reasonable interest rates that they are now selling, although inflated in the tax-exempt market.

Now, I don't know if I have answered your question. I know I have answered some of it, and with that comment, if you could be more direct, I will try and be so.

Mr. VENTO. Well my point is, one of the points that you make is that they are still spending at a greater rate than they are taking in revenue.
Mr. Haehl. What has gone down, sir?

Mr. Vento. Well, you are suggesting they are still doing some financing for maintenance costs, they are still borrowing for maintenance costs.

My point is that part of the spending that goes on is to pay off debt, to pay off bonded debt, I assume, and the interest and service on it. And I think the thing I am trying to get at, is, what is the net effect of that? Not just the fact they are doing it. Is a goodly amount of that going to pay off what are characterized as short-term bonded debt?

Mr. Horowitz. I think, Mr. Vento, maybe the paying off of the notes has been accomplished for the most part through the issuance of MAC's securities; a lot of that has been done through MAC securities.

I am just looking at the City's official statement, the last one dated November 28, 1977, that the debt service has declined that much. I think that figure has stayed reasonably constant.

Mr. Haehl. Debt service, I think, is running at about $700 million a year and will continue high because of the huge amount of short-term debt, short-bonded debt that the City has. There are no more notes outstanding; I believe they have been paid or called in.

Mr. Phillips. I think we pointed out here, the forecast for 1977, 1978, indicates that expenditures will be $377 million in excess of current revenues this year. That is, $18 million funding less $141 million designated as a reserve.

Now, this is borrowed money, and while current expenses are being paid, or even debt service on the notes, if you would, nevertheless that is a current expense item and this constitutes borrowing for that. This is the unacceptable practice—one that is unacceptable, at least, to the investor in the private credit market.

Mr. Vento. Well, my point is, though, how much of that goes to pay out other types of bonded debt, not necessarily the short-term seasonal financing? I think that if I could get that clarified, it would be helpful.

In other words, how many debts, how many bonds do you retire each year in New York? Or are they just paying the service on them and not retiring any?

Mr. Beason. Mr. Vento, I don't have the exact number with me, but they will pay off something like $600 million in bonds in fiscal 1978.

Mr. Vento. I think that is important here because that indicates almost a $300 million step in the right direction in terms of our interests, and maybe you would have to add something to that.

Mr. Beason. May I add just one more point? The debt service for 1978 on New York City obligations, that of the principal and interest, is expected to be $1.627 billion.

Mr. Vento. Well, the debt service is going to remain high. I imagine it was lower to begin with than it was after this crisis occurred in 1975, as indicated by this graph. So the debt service, while a factor that you have to consider, I think we have to note what the total volume is.

Mr. Beason. If you will let me continue, I can give you the rest of the answer.

The debt service for fiscal 1978 for MAC was $440 million. So that is a total of $2.067 billion on a budget of $13.880 billion.
The debt service for fiscal year 1975 for the City was $1.708 billion on a budget of $12.500 billion.

Mr. Vento. So Mr. Chairman, if I might; your interpretation of debt service—is debt service a higher proportion today than it was before as a result of uncertainty in the credit market?

Mr. Beason. No, sir, not as a result of uncertainty in the credit markets. What you have done, you have taken the accumulated deficits of the past, plus the deficits in the first 2 years of the financial plan, and you have financed them long term with MAC bonds. You still have $800 million of accumulated deficit locked in the City's borrowing pattern through the State's advance that has got to be funded long term.

And if you phase out the expense items in the capital budget over the next 3 years, using the most recent numbers given us by the City, the City will have to borrow MAC bonds there at something like—of something like a billion dollars.

Mr. Vento. Thank you.
Thank you, Mr. Chairman.
Chairman Moorman. Mr. Kelly.
Mr. Kelly. Thank you, Mr. Chairman.

Among the people that deal in city finance, to your knowledge, or just using yourself as the criterion, do you have an abiding confidence that the accounting procedures of the City of New York are adequate so that you fully understand what the financial condition of the City is at the present time? Or do it another way: Are the accounting procedures that they're using in the City of New York, and the reporting procedures, adequate?

Mr. Harrises. May I answer first? Mr. Kelly, we do not have that confidence yet, for two reasons: One is our own fault, because we have not had any bond issues of the City to look at, and therefore, we haven't really spent the time with them that we will when they someday decide to return to the market.

Second, there have been several questions which we continue to ask on the new system as it gets shaken down, particularly as it relates to previous numbers which are admitted by the City to be subject to quite substantial change.

Mr. Kelly. So then there is no abiding confidence even that the new system is adequate?

Mr. Harrises. I am only speaking for myself.

Mr. Kelly. I understand.

Mr. Horowitz. Mr. Kelly, I would say that the questions still exist when we hear different budget deficits discussed and the like.

I also want to say prospectively—and I think I say this in full belief—that in the next couple of years New York City will probably have the best accounting system of any municipality in the United States. The controls that are being put on this City, and the outside audit and the IFMS systems and the State oversight—

Mr. Kelly. That is a promise for the future?

Mr. Horowitz. Yes.

Mr. Kelly. This isn't the first time that that promise has been made?

Mr. Horowitz. No, sir.

Mr. Kelly. But it isn't here yet.
Mr. Horowitz. But also this is the first time that they have brought in independent auditors, that they have established an IFMS system; they have done things.

Mr. Kelly. Do you mean after 2½ years of using Federal taxpayers’ money, we are now promised, with some hope of success, that we will have just an adequate accounting system?

Mr. Horowitz. I would say it would be more than that.

Mr. Kelly. It would be more than that?

Mr. Horowitz. More than adequate, I would say.

Mr. Kelly. Mr. Beason, you suggested there wasn’t any other way except Federal help. Is it an impractical thing in New York, for a City in trouble, deep trouble, on the verge of bankruptcy, to just call upon its people to make some sacrifices to help the City? If the employees here in this town are paid the highest wages in the United States of America, it is not a question that they can’t live on it, because it is the fringes that we are talking about, but couldn’t they be called upon to voluntarily reduce their demands on the City? Because the questions of labor cost, debt service, and welfare in this town constitute something over $8 billion out of a total budget of $13 billion, or that was true in 1975.

So what I am asking is: Is it not reasonable or rational to just call upon the citizens to make this sacrifice for the common good, and has that been done to your knowledge with any force in any organized way?

Mr. Beason. Mr. Kelly, I believe you will recall that I stated in my testimony that what we are talking about is the City’s achieving a balanced budget. We are here to talk about how you get the City financed.

I think how a balanced budget is achieved really belongs with the elected officials, and they understood——

Mr. Kelly. Well, then, you did not intend to preclude something such as I suggested in your statement?

Mr. Beason. Mr. Kelly, my statement stands as it was written.

What I am trying to say to you sir is, I believe the decisions about how the budget balance is achieved have to be made by the elected officials.

Mr. Kelly. But what I am saying is: Your statement did not intend to exclude another possibility?

Mr. Beason. My list of things that the City was going to have to do was not all-inclusive, but included in the list was that the City had to get itself in a position so it could consistently produce a genuinely balanced budget.

Mr. Kelly. Mr. Phillips, in your statement you said, quote:

As a first step in achieving fiscal stability, financial reporting must be improved and deemed dependable.

It is very disquieting at this point, despite 2½ years with outside auditors and a myriad of consultants, that almost every significant City budget number in the ongoing discussion of the City’s financial position has been changed not once, but repeatedly.

Well, has something happened to cause you to believe that this statement you made isn’t accurate?

Mr. Phillips. No, sir.
Mr. Kelly. It is still true?
Mr. Phillips. Yes, sir.
Mr. Kelly. Do you hate New York?
Mr. Phillips. No, sir.
Mr. Kelly. Thank you, Mr. Chairman. I will rest my case.
Chairman Moorhead. Mr. Hubbard.
Mr. Hubbard. Thank you, Mr. Chairman.
Congressmen McKinney and Caputo and Badillo and still Congressman Koch, of course, represent constituencies which benefit greatly from New York City. Indeed, my absent colleague, John LaFalce, and my friend, John LaFalce, to a degree, his constituents benefit from New York City.
But indeed there are some on this subcommittee, and of course, the majority of Members of Congress, whose constituents do not accrue benefits from New York City. The benefits of this City accrue to people throughout the tristate area, people in Westchester County, northern New Jersey counties, Long Island, and the Connecticut suburbs, who make their living in New York and take advantage of the City's impressive cultural and entertainment resources as well as its police and fire protection.
Not intending to be personal, but to prove a point at this hearing, all four of the leading financial experts in the City of New York, do all four of you work here in New York City?
Mr. Harris. Yes, sir.
Mr. Phillips. Yes.
Mr. Beason. Yes.
Mr. Hubbard. Do any of you live in New York City?
[No response.]
Mr. Hubbard. None of you? I just thought I would make that point. None of you four live in New York City.
Well, let me ask you four who are asking the people down in western Kentucky to help finance the financial dilemma of New York City: none of you live here in New York City, you live in the suburbs, but you work here, you accrue the benefits here. Would you be in favor of a commuter tax to help balance the budget here in New York City? Would you be in favor of a commuter tax?
Mr. Beason. Mr. Hubbard, I am a resident of the State of New Jersey. I pay a commuter tax to the City of New York and the State of New York.
Mr. Harris. As of yesterday, you pay a tax in the State of New Jersey.
Mr. Beason. I pay a personal income tax in the State of New Jersey.
Mr. Hubbard. But you do pay a commuter tax in New York City?
Mr. Phillips. Yes.
Mr. Harris. I am sorry this hearing wasn't held in Washington, Mr. Hubbard. I could have had a day I worked out of New York, and I wouldn't have had to pay taxes on it.
Mr. Hubbard. How much is the commuter tax in New York?
Mr. Koch. Commuters pay one-sixth of the tax that the residents pay, and they should pay more.
Mr. Hubbard. You did hear that from the mayor-elect, that the commuters should pay more?
Mr. Horowitz. I would disagree with him, but I think one of the problems is that the commuters also pay tax in their own communities, too. But if you want a personal opinion which has nothing to do with anything other than me, and I live in New York State, I think that I earn my living here, I benefit from the protection here, and I would not object to paying a higher commuter tax. I make my entire livelihood here.

Mr. Hubbard. Then Mr. Horowitz, you could agree that a higher commuter tax for the people of Connecticut and New Jersey and Long Island—

Mr. Horowitz. I am talking for me.

Mr. Hubbard. Would you agree—and I will close shortly—would you agree that the bridge tolls could be increased coming into New York City?

Mr. Horowitz. I will give you an opinion on that, too. I've got an opinion on everything.

I think that if you live in Brooklyn, which is part of New York City, you should not have to pay to go to Manhattan. But I think if you live in Nassau County, you certainly should pay. I don't think a resident of New York City should have to pay to go from one borough to another. It is all one City. But if the City is maintaining those bridges for a guy outside the City—

Mr. Hubbard. Nassau County, Connecticut, New Jersey: You think the bridge tolls could be and should be increased?

Mr. Horowitz. There are no tolls on those bridges.

On the East River, why should a person who lives in Brooklyn be penalized because there is a body of water between Brooklyn and Manhattan.

Mr. Hubbard. But on the bridges that do have tolls, and where the bridges should have tolls, you would have no argument that they could be increased to help finance the City of New York.

Mr. Horowitz. Well, just to be specific, the bridges that have tolls are not involved with the City of New York. They are either the Port Authority bridges or the Triborough Port Authority bridges.

Mr. Harriss. And were raised 50 percent, Mr. Hubbard, about a year ago.

Mr. Hubbard. But in closing, Mr. Chairman, I would say to you: Can you see why people way off from New York City do have questions about rent controls and bridge tolls and commuter taxes that are legitimate, where they are in fact asked out there in Kentucky and Wisconsin and Oklahoma to help share the financial dilemma of New York City?

Mr. McKinney. Would the gentleman from Kentucky yield for a moment?

Mr. Hubbard. Sure.

Mr. McKinney. As a Representative from Connecticut, I should state that my constituents pay a commuter tax to New York and have no State tax system to write it off against. It is a direct payment to the City, and I think most of my commuters will be willing to pay more. I hate to commit them to that, but I also hope the gentleman will now cosponsor my reciprocal income tax for the city of Washington because Washington is bled dry every week by nonresidents also.
Mr. Kelly, including Congressmen?
Mr. McKinney. That is right.
Chairman Moorhead. Mr. Caputo. Mr. Caputo. Mr. Chairman, I would like to state, just at this point in the record, that we are not here deliberating over an aid program to New York City; we are deliberating over a loan which we plan to repay on time with interest at a profit to the taxpayers of the United States. And somehow these deliberations always seem to gravitate toward New York City getting something for nothing. And that is not what anyone has requested or suggested to my knowledge.

We are here to discuss extending a program which has returned handsome profits to the Federal Treasury; which has not been a drain on the taxpayer, but instead, the opposite. And I know it is kind of fashionable in Washington to talk about internal New York politics and to criticize New York for asking for an aid program that would not be provided to the rest of the country.

That is not what the New Yorkers have asked for. That is not what the New Yorkers have received. And it is not the issue before us.

We are talking about borrowing money from the Federal Government at 1 percent above the cost to the Federal Government of obtaining that money. Further, we are talking about making a taxable loan, the Federal borrowing, underlying the loan to the City instead of a tax-free loan, which could produce as much as a quarter of a billion dollars of unanticipated revenue to the Federal Government.

Now, I know how colorful and pleasing it seems to be to people who don't come from New York, and I am ready to take that. But when we vote, I hope we understand that what we are talking about is a self-sustaining, in fact, a profitable, instrument from the Federal Government to the City of New York.

Nobody in New York is asking for something for free. We are not asking for aid that any other American would not get.

Now, I would like to return to the dialog on guarantees versus loans. I think one of the dilemmas for Mr. Rohatyn was that this year it would be impossible for the Federal Government to buy MAC notes without amending the second and final budget resolution passed by the Congress in September 1977, a guarantee, probably, or at least arguably, would not be an on-budget item, and would not have to pass through the congressional budget mechanism.

So there is a possibility that we could get guarantees this year without a third budget resolution. And there has only been one third budget resolution in the history of the budget process, and that was for President Carter's economic stimulus program. All we can get is guarantees, and that is why the interest in guarantees.

The objection to guarantees, as I understand them, would be, No. 1, why would only New York City get the guarantee? Well, the only reason is that New York City would be the only one required to make the commitments to balance its budget, to limit its borrowing, and the implied commitments to lay off employees, to cut services, and the other things necessary to get the guarantee.

The Federal guarantee would come with very strong attachment that few municipalities would want to undertake unless they absolutely had to. Much like the IMF, this would be an instrumentality to
enforce fiscal discipline for the benefit of the national municipal market. Few would want to do it unless they had to; indeed, the controls would have to be so strong that few would want to do it unless they had to, and that is the Kohatyn guarantee proposal.

The second objection was that it would create a tax-free instrument that was backed by the Federal Government, paper better than the Federal Government's own paper.

Well, there are a number of ways to improve on that. You could make it taxable. You could have some kind of return mechanism to the Federal Government for that.

Are you convinced that the consideration of guarantees is inappropriate?

Mr. Honowritz. I have to ask a question on this. If you say you are going to limit it to New York City, what is Mr. Hubbard going to say, and what are his constituents going to say?

Mr. Caputo. No, I meant to say just the opposite: that I would make this available to any municipality, but you have to take very strong medicine, like subject yourself to a Control Board, which went down very hard, if you will remember, with locally elected officials.

Mr. Honowritz. Well, let me ask you, Mr. Caputo, assuming you did this, and something happened, do you really foresee that we wouldn't be sitting here at another hearing say 10 years from now or 8 years from now, the Federal Government is going to withdraw its guarantee from New York City securities. I mean, wouldn't we be exactly in the same boat that we are talking about today. I mean, the same arguments would apply.

And I don't want to get into it with Mr. Hubbard, but this City does have a lot that it does for Kentucky, too. I really believe that.

Mr. Caputo. My time has expired, and I would just like some other thoughts on loan guarantees.

Mr. Haines. Well, I will very quickly say that my view of the guarantee is that it is an expensive way to go. The bond would have to be taxable, and no guaranteed bond ever takes the same interest as the guarantor; there is always a premium penalty.

Chairman Moon. I think if you gentlemen would want to expand on this question in writing, we would deeply appreciate it.

Mr. Koch.

Mr. Koch. Mr. Chairman, I just have a brief comment.

Something was said about living in the City of New York. One of our problems has been that over the last 10 years, approximately a million people of middle class status have left the City of New York, and a comparable number of low economic status, requiring support and assistance, have entered the City of New York from all parts of the country, as is their right as American citizens.

I am not here to defend the City of New York as far as people having made the determination at some point to move or not to live here. But it is my hope, and my expectation, that as a result of a change in the climate of the City of New York, as a result of services that will be provided in a better way, I hope at least to do that, that those who left will come back and that those who have thought of coming here but have deferred it, will likewise come. Particularly, I hope those who have worked with the City of New York and made
their living from the City of New York, will feel an obligation to come into this rowboat with us.

Thank you, Mr. Chairman.

Chairman Moorhead. Thank you gentlemen very much.

The subcommittee will now stand in recess until 2 o'clock.

Mr. Kelly. Mr. Chairman, for the record, was that a rowboat or a lifeboat?

Chairman Moorhead. At 2 o'clock, we will have Mayor Beame as our first witness.

[Whereupon, at 1 p.m. a lunch recess was taken.]

AFTERNOON SESSION

Chairman Moorhead. The Subcommittee on Economic Stabilization will please come to order.

At this time the subcommittee members are privileged to hear a statement from a very distinguished public servant who has served the people of his City long and ably.

We are honored to have you with us, Mayor Beame.

STATEMENT OF HON. ABRAHAM D. BEAME, MAYOR, NEW YORK, CITY, N.Y.; ACCOMPANIED BY DONALD KUMMERFELD AND JOHN BURTON

Mayor Beame. Distinguished members of the subcommittee, I want to thank you for this opportunity to report to you on our City's progress toward fiscal recovery, and our prospects for the future, and the case for continuing the City, State, and Federal partnership that has enabled the City to advance on a sound fiscal course.

I am pleased to report today that the City has more than fulfilled its obligations under the seasonal loan program. When the fiscal crisis became apparent, the City was struggling with a deficit of more than $11 1/2 billion inherited from the prior administration.

The City has completed the first 2 years of the financial plan which was developed in the fall of 1975. We have met and exceeded our targets for both fiscal years. In 1976 we reported a deficit of $968 million, $83 million under the plan. In fiscal 1977 our deficit was $320 million, $337 million better than anticipated.

With the fiscal year beginning this past July 1, we have achieved the goal of a balanced budget consistent with the requirements imposed under State legislation.

For this fiscal year, our actual results meet anticipated targets, and a general reserve of $141 million remains available to cover any unexpected revenue shortfalls or uncontrollable cost increases. Of course, all budgets are subject to uncertainties, but I feel that the fiscal 1978 budget is in good shape.

In addition, our financing for this fiscal year appears to be adequate. Our seasonal needs will be supplied through borrowings under the Seasonal Loan Act, and our long-term needs through borrowings from the City's own pension and sinking funds in the first 6 months of 1978. We now forecast a cash balance at the end of the fiscal year of $278 million which will cover fluctuations in our cash flow estimates.
For fiscal year 1979 we project a gap between revenues and expenditures estimated at $249 million. This gap could be impacted by a number of difficult policy decisions which the new City administration will have to make after January 1. These include the results of labor negotiations and the impact of any changes in the present timetable described by law for phasing out capital budget support for certain operating expenses.

While the City's leadership is committed to keeping the budget in balance, it is clear that a balanced budget cannot be maintained over the next several years without a critical and ultimately counterproductive cut in essential municipal services, by increases in Federal and State assistance, or by significant real growth in the City's economy.

Our City shares the same long-term outlook as many other older urban centers: our local tax revenue growth cannot keep pace with the uncontrollable annual spending increases forced by national inflationary trends—even if one excludes possible wage increases for City employees.

This undisputed trend defines the limits of local self-help efforts toward fiscal and economic recovery. It offers compelling proof of the essential need for State and Federal assistance to reverse the decline of our urban areas.

The City of New York has taken giant steps. Despite our fiscal difficulties, my administration has put into place a business tax reduction program totaling $400 million over the next 5 years. Of this sum, $200 million already is reflected in our budget. In addition, legislation has been enacted to provide new incentives for business employment and investment.

Partial relief lies in a greater State role in financing some items now included in the City budget. We are asking the State government to provide full State financing for functions which are properly the State's responsibility, such as City University costs, our court system and our corrections facilities. We also seek more equitable State support through formula changes in other areas.

However, New York State has neither the economic strength nor the constitutional authority to satisfy all the unmet needs of its urban areas. As the Carter administration and the Congress have recognized, many urban fiscal burdens result from national problems that should be addressed at the Federal level.

This certainly is true for mandated welfare and medicaid expenditures. These two areas alone demand over $1 billion in City tax levy dollars annually. Relieved of these acknowledged national problems, we would have a fully solvent City of New York.

The special needs of all our older cities were recognized this year in the enactment of an economic stimulus program which has helped reduce the impact of persistently high unemployment levels in some parts of the Nation. That program should be continued. Looking to the future, we hope that the President's planned urban policy document will address the long-term redevelopment needs of our center cities.

Indeed, the New York City fiscal crisis spotlighted the economic problems facing our older urban areas. Our crisis has alerted public officials at all levels of government to the ultimate price of neglect in
facing up to urban problems. Our City’s progress in the past 2 years has shown that it can slow down economic decline and avert fiscal chaos—if it has appropriate Federal and State support. I am not speaking of handouts when I refer to support. Rather, I speak of the need to give us the tools and the time to work out our problems.

The stability of the Federal loan commitment provided the basis for reorganizing the City’s debt structure, redirected its budgetary policies, and moved to preserve our economic base. Most important, by approving the Federal loan program, Congress dispelled with one step the crisis atmosphere which had plagued the City and State for over a year and which had made lasting progress impossible.

Although we have made impressive strides toward fiscal recovery, the City’s short-term and long-term financing needs can only be met by the private markets when those markets are assured that the City has achieved long-term economic stability. As the City moves toward that goal, with State and Federal support, financing assistance will be needed in the form of continued seasonal loans and long-term debt guarantees by the Federal Government.

It would be tragic, indeed, if the Congress permitted the City to plunge back into the fiscal nightmare of 1975 and thus set back the clock on our steady progress toward market acceptance.

I hope that the Congress will renew the Seasonal Loan Act without extensive delay, thus avoiding the market uncertainties and other problems that would occur if the act’s renewal became a cliffhanging drama.

It should be noted that this program has been highly profitable for the Federal Government. The City will have borrowed and repaid more than $5 billion under this legislation by June 1978. We will have paid more than $200 million interest on these loans, of which $30 million constitutes the 1 percent interest fee imposed on the City in excess of the Federal borrowing rate.

The City interest payments, set above the Federal borrowing rate, contrast with the total 2 percent interest charge on many U.S. loans to foreign governments. Certainly, the City’s well-being is at least as important to our Nation as the well-being of these other countries.

Deducting administrative costs, we estimate that the Federal Government will have earned a profit in excess of $25 million on the seasonal loan program. There are few Federal programs that offer a profit to the Government.

At this point in our City’s recovery effort, it appears that it continues to be profitable to both the City and the Federal Government to maintain this relationship.

The current inability of the City to meet its seasonal financing needs in the private market was highlighted in November by our unsuccessful attempt to sell $900 to $600 million of revenue anticipation notes to the public through a syndicate of underwriters. This planned sale failed despite enormous efforts by City and State officials.

I might say parenthetically it was due basically to the rating which Moody’s gave to those notes, and in the same breath that they downgraded the notes, in the same breath they said they have no doubt that these notes are going to be paid on time. And that is all we were asking them for, was a rating on those notes.
Had it been a rating of 3, the underwriters indicated that they could have handled the sale.

I believe that the most reasonable way for the City to get back in the long- and short-term markets would be through a program of Federal financing assistance which phases out over a period of years. This would include $2 billion of seasonal financing available in 1979, reduced by $500 million a year until the program ends on June 30, 1982.

With this assistance it should be possible for the City to meet its seasonal needs increasingly in the private market place during the life of the program. Naturally, it would be in the City's interest to minimize Federal borrowings because of the lower interest rate which the private market offers to tax-exempt securities.

In fiscal 1977 and fiscal 1978, the City has repaid more debt than it has sold and our total debt outstanding will have dropped by $700 million between June 30, 1976, and June 30, 1978, to a level of $11.3 billion. During this time, we have repaid or refunded all of our short-term debt. We believe that if we are able to finance our actual capital needs in future years by the sale of approximately $1 billion of long-term bonds annually, debt service can be stabilized at an annual level between $1.8 and $2 billion.

In order to sell this debt, which will be a major factor stabilizing the fiscal position of the City, we believe that the Congress should consider a program of Federal guarantees which would enable cities such as New York to rebuild their market acceptance.

Despite the remarkable progress the City has made in reformatting its accounting procedures, balancing its budget, and repaying all publicly held short-term debt, it is not likely that the City will be able to sell its own long-term bonds in sufficient amounts to meet our capital requirements of approximately $1 billion annually over the next 3 to 4 years. The employee pension funds, which have been meeting our long-term financing needs for the past 2½ years, could not continue this role past June 30, 1978, without jeopardizing their tax-exempt status under Federal law. While MAC has potential additional borrowing capacity of $2.5 billion, it is not certain that MAC will be able to market successfully the full amount of this capacity. Accordingly, MAC's ability to sell securities in the public credit market should be preserved for these purposes: One, to refund high-interest and short-maturity MAC bonds, thus providing budgetary relief to the City; two, to refund certain City obligations in order to lengthen their maturity and to reduce annual City debt service; three, to bond out the $800 million State advance, thus reducing annual City seasonal borrowing requirements; and four, to provide a contingent source of financing for the City in the event of City financing difficulties.

Thus, it seems highly desirable if not essential that federally-guaranteed long-term financing be made available to the City if we are to meet even our minimal capital needs over the next 3 or 4 years.

In August 1974, I urged such a program in testimony before the Subcommittee on Long-Term Growth of the Senate Finance Committee. Credit guarantees long have been used as an instrument of Federal policy. In 1975, we pointed out that the U.S. Government had more than $900 billion in debt guarantees outstanding.
In 1976 the Virgin Islands was successful in having a guarantee bill passed through the Congress and signed by the President; why not our cities?

Our efforts over the past 2 years have proved that our three levels of government can steer a course toward a lasting solution of the City’s budgetary crisis.

It is clear that this course is least expensive to all concerned—because the alternatives would have disastrous, costly impacts on the City, the State, and the Nation. Given appropriate credit assistance, at no cost to the Federal Treasury, the City of New York can continue its progress toward fiscal solvency.

The City of New York has met every test imposed on it by the State, by the Federal Government, and by the courts. Our solid record of progress has been acknowledged by two Presidents, their Treasury Secretaries, and many Members of the Congress.

We have forged a successful alliance which has given all our troubled cities new hope for revitalization. I urge you not to withdraw the Federal Government from this historic effort.

Thank you.

Chairman Moonbeam. Thank you, Mr. Mayor. For the record, I wonder if you would introduce by name and title the associates you have accompanying you.

Mayor Beame. To my right is the first deputy mayor, Don Kummerfeld; and to my left is the deputy mayor for finance, John Burton.

Chairman Moonbeam. Mr. Mayor, I am very sympathetic to the situation in your City, and if I ask you a question that is a tough one, it is not because I am not sympathetic but because I would rather have the answers on the record.

Mayor Beame. I appreciate that.

Chairman Moonbeam. Your proposed financial plan for 1979 projects a deficit of close to $250 million. A recent newspaper story indicates that the projections of revenues and expenditures for the next 4 years show an increasing deficit, not a declining one.

Is that story accurate in your opinion, sir?

Mayor Beame. Well, may I put it this way; these data have not come to me. Our staffs are working on information, or at least on developing revenue and expenditure needs for the next 4 years.

It isn't in final shape, nor have I seen it. I know Mr. Kummerfeld has been leading this effort with some of the staff and has not discussed it either with Mayor-elect Koch or his people. So there is no question in my mind that there are going to be gaps, the extent of which it is very difficult for me to make any observation about without having the final data.

Chairman Moonbeam. Do you want Mr. Kummerfeld to comment?

Mayor Beame. Yes.

Mr. Kummerfeld. I think it would be inappropriate for me to corroborate numbers that appear in the press when we are in a working document situation, but I would like to say two or three things.

Based on realistic and conservative projections of what the New York City economy is going to do over the next 3 or 4 years—and this is after discussion with many economists in the City, the commercial banks and universities, our own economists in the City government—
the consensus view is for a very modest kind of recovery from the spiral of disinvestment we have had over the several years. This is based on conservative but also, I think, realistic views of inflation and uncontrollable costs in medicaid, in welfare, in the purchase of fuel and energy, and all of these other things over which we have no control.

There is no question that the increase in revenues, tax revenues, coming to the City at existing tax levels doesn't go up as fast as the increase in inflation from these uncontrollable costs. And therefore you do have continuing and growing budget gaps because of this basic imbalance.

The economy is simply not generating revenues as rapidly as inflation, and expenditures at existing service levels, and there is no way around it.

A second thing: In this exercise we are attempting to see if we can come up with a plan that would balance the budget over a reasonable time period of 4 years while phasing out all of the capitalized expenses that are still carried in the budget, some $650 million.

That obviously adds a much larger budget-balancing gap problem, some $331 million more than it would be if we phased out our capitalized expenses on the present statutory 8 remaining year period of time. So it is a tough problem and the gaps are large. And it will take in my view increased revenues from the Federal Government; increased revenues from the State; and further reductions in expenditures; all of these things, in order to close this gap.

And I think that therefore the City can expect to have a continuing problem with budget gaps.

Chairman Moorhead. Will the figures that you consider accurate be available?

Mr. Kummerfeld. Well, Mr. Chairman, I am not controlling this release. I have been asked to do this by the Secretary of the Treasury after consultations that he had with the Governor and with the mayor-elect, the City comptroller, and others; and I am simply responding to that and making this material available to these people. I really cannot control the release of this information, and it is not under my jurisdiction.

I will say—and I want to emphasize—that when you look into the future, there are no two people who are going to make exactly the same estimates of inflation rates, and of all these other things. So reasonable men will differ on the precise size of this, and I would expect that there is not going to be uniform agreement on what is the quote unquote correct estimate.

I suggest that if you ask five leading national economists about how much the Federal budget was going to be over the next 5 years, you would get differences in view at least as large as the differences that you have heard about in the New York City budget gap.

Chairman Moorhead. Thank you, Mr. Kummerfeld.

My time has expired, Mr. McKinney.

Mr. McKinney. Thank you, Mr. Chairman.

Mr. Mayor, it is good to see you again. I wish after our struggles of 2 years ago that we were not back struggling over the same subject.

I think, Mr. Chairman, that it is time for me to put on the record as an observer that I agree with the mayor on the State's role. I think
the State has had a very good bargain with New York City. New York City has carried its entire court system, its university system, its hospital system, all of which in other cities in this great State receive copious amounts of money from county and regional tax bases that New York City does not have available to it.

I think it is very important to remember that, because quite often people say, well, why should New York be different. The fact is, it is different. It has done a great deal for the State, and I think it is time that the State recognized that and rewarded that.

Mr. Mayor, there are two things—I would like to ask Mr. Kummerfeld a question first. You used an expression which, as ranking member of the District of Columbia Committee, I am only too familiar with: “existing tax levels.” They are already regressive and too high, aren’t they?

Mr. Kummerfeld. Well, I am giving you one person’s view. I think if they are raised any more, they will be counterproductive. That is, I don’t believe that the total volume of funds collected at higher rates over the next several years would exceed the volume collected at the present rate, because I believe we are at a point where we are driving middle- and upper-income people out of the City, and businesses out of the City, because of the existing tax levels.

Mr. McKinney. So in essence by that statement you just made you are already saying that they are already counterproductive.

Mr. Kummerfeld. Well, certainly, we wish we could reduce them more. We are at a situation where we have to balance the budget, and we think that the significant tax reduction which the mayor read into his statement which was aimed at those business taxes that fall particularly on businesses during the business year, and make it uneconomic to do business in New York City, and those are important signals to the business community that we hope will change the climate for private investment and therefore will give some stimulus to the economic recovery program that is so essential to the future of our tax base.

Mr. McKinney. Mr. Mayor, would you like to comment on that?

Mayor Brant. I would like to before we forget some of the things you have said. I think you said something about New York City has done a good deal for the State, and therefore, the State ought to do something for New York City. I don’t dispute that at all. I mentioned the fact that we had helped the State balance its budget; I say $270 million in the last 3 years, which they normally would have to match and didn’t have to match.

But New York City has done a good deal for the country, and I think that there is just as much a responsibility in that regard.

And furthermore, even if the State did everything that we are saying they should do, take over these functions as I indicated in my statement that I started, it could not meet all the needs, and the Federal Government has a responsibility to take our backs their responsibilities, which they recognize, and which have been recognized in Congress as Federal responsibilities—welfare, medicare, the illegal alien problem, the drug problem. We can’t control the flow of drugs into this country; only the Federal Government can. We can’t control the illegal alien problem; only the Federal Government can. And so I say the Federal Government has to recognize its responsibilities.
Mr. McKinney. Mayor, one of the problems we had when we had the last go-round with New York City was that Congressman Thomas L. Ashley and myself and several others wanted to provide a long-term program for the City but the administration and others opposed it. One of the problems we had recently is what I call the "budget of the week syndrome"; every week we had a different budget, so that members of this subcommittee would labor through the 400-odd Members of Congress trying to convince them to help New York City, and have the rug unceremoniously pulled out from underneath us the next week by another figure. I read in the papers the same increasing confusion as to the budget. You mentioned a figure of $200 million; one article tells me it's $400 million; the next day I pick up the paper and it tells me it may be as much as $500 million.

Why can't we get a hold on this figure?

Mayor Braman. You have got a hold on it, if you are going to look to the source that has the responsibility for this. Now, I would like to see that newspaper that had the $400 million and $500 million figures give me a detailed list of where we are wrong in what we submitted officially to the Control Board of the State of New York and to the Federal Government. We submitted this document, which I think you have a copy of. And this document sets forth every single item and assumption.

Now, where there is a difference of opinion in assumptions, that is a matter than can be disputed or argued out. Our number is $249 million, and we believe it is right. Now the fact that the newspaper will put in another number does not make it wrong.

Mr. Kummervold. Could I address that question? I think there is some confusion. In 1973 one of the problems was that the accounting and budgeting system of the City had internal inconsistencies and was in a state of flux, and that was a problem—of knowing what the existing facts were about the City's finances.

That is no longer the case. With our new budget and accounting system, which Deputy Mayor Burton can describe, none of the existing oversight bodies are arguing about the existing data base, the current spending numbers. The only arguments have to do with projections into the future, and the differences between the different groups who project have to do with what will the Federal Government do about future revenue increases? Will the Federal Government extend countercyclical, will it extend CETA? Some say, "yes," some say, "no."

What will the State do with regard to certain future actions on all of the differences having to do, not with the existing data base, which we all agree on, we are all using the same data base now; but it has to do with individual judgments about what other levels of government, that is, the Federal Government and the State, will do in the future that impacts on our budget.

Mr. Koch. Mr. Chairman, could I be taken out of turn just for one moment to make sure the subcommittee is not working under a misapprehension?

Mr. Badillo. It is my time and I will yield to the gentleman.

Mr. Koch. Because I don't want the subcommittee to be laboring under an impression that may erroneously have been conveyed. Don
Kummerfeld and the current administration are responsible for the current figures. I think there may have erroneously been conveyed the thought that in some way or other I agreed with these figures, or the release of these figures. I don't think you wanted to convey that?

Mr. Kummerfeld. Absolutely not.

Mr. Koch. There is no agreement with respect to withholding information or releasing information. I don't take charge until January 1. I am not responsible for these figures, nor have I signed off on any figures that are projected.

I just want the subcommittee to understand that there is no agreement about changes or concurrence in what might ultimately be the budget gap. That is the responsibility of the current administration. I will release my figures subsequent to January 1.

Mr. Badillo. I just wanted to add that the mayor's program is based on $1 billion for the long-term needs, with the short-term needs being financed by an extension of the seasonal loan on a reducing basis of $500 million a year.

Actually, if some of the conditions that Mr. Kummerfeld indicated occur, then the figure would rise, and the amount required to extend the seasonal loan would have to be greater. So that the basis for the testimony is based on the assumptions that you have made. Isn't that correct?

Mr. Kummerfeld. That is correct.

Mr. Badillo. And if the assumptions were to change, then the amount of money by which the seasonal loan would have to be extended would have to remain closer to the new level?

Mr. Burton. That is not true. The seasonal loan reflects the difference between cash inflows and cash outflows on a seasonal basis. It relates to the $600 million State advance, the $600 million education and $400 million in State revenue sharing. Certainly in terms of the total financing needs, if the deficit were to be financed by the sale of debt, you would need more debt if the deficit were higher.

However, in fact, we are mandated to reduce that, so I don't believe it would affect the financing needs. It would have a very substantial effect, of course, on the budgetary policies that would be followed.

Mr. Badillo. But you take the position that in any event, you would want the seasonal loan reduced by $500 million?

Mr. Burton. Yes.

Mr. Kummerfeld. Let me say for the record that we have compared reconciliations between the projections released in the mayor's financial plan for 1979 and the projections made by the special deputy State comptroller, and also the projections made by an advisory group to the mayor-elect. And you can see there are two or three key differences in assumptions about future actions that make up the entire difference, and we can submit those to you if you like, and you can run through and see what those differences are.

Mayor Beame. As a matter of fact, as far as the special deputy is concerned, his figure is in that report that I just held up to you.

Mr. Burton. Congressman, I should add that the recommendation of a $500 million reduction every year is not an indication necessarily that our seasonal needs will go down, but that we will be able over this period of time to meet our seasonal needs, to the extent they
exist, in the public market. So we expect to gradually return to the public market, with a gradual reduction in the Federal seasonal loan.

Mr. Baddino. Thank you.

Chairman Moorhead. Mr. Vento.

Mr. Vento. Mayor Beame, welcome to the subcommittee. I have just begun service in this Congress on this subcommittee, so I did not have the benefit of looking at these problems during the crisis period of time in 1975.

But in looking at them now, I am concerned. I find your statement very useful. You suggested that the total net debt of the City since that point has been reduced by about $700 million, which to me, is meaningful progress. I had a hard time getting a statement that there was a $300 million step forward last year from the last four witnesses that were here, who were all bond-rating people. But they did look at the shortfall between revenues and expenditures that did occur last year despite the fact that some of it has gone for a debt reduction of about $300 million as I understand last year.

What are the steps—for instance, the next 4 years; how much will the debt ceiling drop for New York? What does it look like in terms of your projections, if you can recall?

And I guess that has to be kind of a general question. I can't expect a specific answer to that. But what does it look like the next 4 years—I would like to know what is going to happen that will enable you to return to the private market with a diminishing seasonal loan proposal like you have here today.

Mr. Burton. We can submit some additional information.

I think in general terms, it will depend—the magnitude of the debt outstanding—will depend on the magnitude of additional debt that we need to sell for our capital programs. If our plan, which is about a billion dollars a year of new debt for our capital programs, were to go into effect, there would be a slight increase in the total amount of debt outstanding, and the new debt would slightly exceed the amount being paid off, but it would not be very substantial during that period of time.

Mr. Vento. Doesn't that present some problems in fighting the private market that persists or will persist in 4 years with that type of scheme?

Mr. Burton. No, I don't think so, because I think the key to our plan is to equalize our annual debt service charge, on a long-term basis. And our plan does contemplate debt service equalized at between $1.3 and $2 billion per annum for 20 years in the future, assuming approximately $1 billion a year of annual debt outstanding.

Mr. Vento. What percent of your budget—of a $10 billion budget, what percent goes for payout of bonded debt right now? The mayor mentioned he had $13.5 million that was uncommitted that he had to keep squeezing.

Mr. Burton. $3.5 million.

Mr. Vento. Excuse me; what percent goes for payout on capital bonds?

Mr. Burton. Our plan for fiscal 1979 contemplates approximately $2 billion for debt service out of $14 billion, and that would be $2
billion also out of what might be called $8 billion of City funds, exclusive of Federal——

Mr. Vento. When you define debt service, that is both principal and interest?

Mayor Beame. That is right.

Mr. Kummerfeld. It is about 1%, I think.

Mr. Vento. What types of limits have you faced regarding policy-making as a result of the State Control Board actions that may have cost you more money; and I am not talking about dollars and cents now. Have you faced decisions that you think have been more costly or adverse to the decisions that you made, not in terms of human resources—obviously, that is a different question. Do you see decisions that have been coming forth that have ended up costing you more?

Mayor Beame. The decisions of the Control Board?

Mr. Vento. Yes.

Mayor Beame. No, other than the fact that there have been delays, and those are problems which affect various things.

For instance, the ability to render services.

Mr. Vento. Yes. One more question, and my time has elapsed, is: you talked about the insured loan aspect of Government. That will be a higher interest rate, which means that your debt service cost will actually be higher than——

Mayor Beame. What do you mean when you say a "higher rate"?

Mr. Vento. Well, it is a taxable, insured bond—would be a taxable bond. Wouldn't that be a higher rate?

Mayor Beame. Well, let us assume it is. It would still be a lower rate than we are paying today.

Mr. Burton. Our projections are between 8 and 9 percent. We currently are selling long-term debt to the pension funds at a 9-percent rate in accordance with the agreement with them, and our projections indicate between 8 and 9 percent gradually being reduced over a 15-year time horizon, as our credit improves. But I don't believe a federally guaranteed loan would have any material difference at all compared to the kind of rate. If anything, it might reduce it.

Mayor Beame. I am not so sure about that. It seems to me a federally guaranteed—we are not arguing—we never talked about this before—but it seems to me a federally insured security would obviously carry with it an assurance to the person who is buying it that it would be paid, and paid on time. And that obviously has an effect on the interest rate. And it would hardly be much more than the Government pays.

Mr. Vento. Well, I hope that would be the case, but I don't know if for a fact.

Mayor Beame. I don't think anybody knows if for a fact.

Mr. Kummerfeld. There is a very large federally guaranteed market, and one can simply look at the rates on all the federally guaranteed paper that is traded, and draw their own conclusions; it is a matter of fact.

Mr. Vento. Thank you.

Chairman Moonbeam, Mr. Kelly.

Mr. Kelly. Mr. Mayor, it certainly seems that the whole thrust of our hearings today have dealt with, how are we going to finance New York, and there have not been many questions about whether we
should. And I want to go back to the business about whether we should or not.

One thing that concerns me is, you have chosen in your wisdom in New York to pay the people who work here the highest wages in the United States of America for public service employees when their fringe package is included. Now, have you gone back to these people and said: "Look, gang, we're in trouble. We're bankrupt. And we're going to have to start going to Washington with our hat in our hand asking for help in a way that no other city in America goes, when we are the richest city in America. So we think it reasonable that since we have come on hard times, and you are the principal cause of it, that now you should start to bring your pay levels down somewhere within the crowd and not be getting the best while everybody is being asked to pay for it."

Now, have you ever gone to these people, and can you document that?

Mayor Beame. I will tell you about that, but let me first answer your first opening comment about—you wonder about whether the people of your State—

Mr. Kelly. That wasn't my question, Mayor, that was your conclusion. I would like to get my question answered: Have you gone to the people and asked them to reduce their salaries?

Mayor Beame. I would appreciate it if you would let me answer the question in the way that I want to do so, and then if it isn't appropriate, why, you can say whatever you want.

One reason we think, first, if New York were not going to be helped, we would not be able to send $100 million to Florida.

Mr. Kelly. Mr. Chairman, I have no objection to this witness talking as long as he wants to, but if you are going to charge me for the time, I want an answer to my question: Have you gone to these people and asked them if they will take a reduction?

Mayor Beame. We have not only gone to them, we have had them in and it is in the record.

The negotiations and decisions, we have had them in. We negotiated a 2-year no-cost contract with them based purely on getting a cost-of-living adjustment if productivity warranted that.

Mr. Kelly. Did they tell you at that time that they would take the reduction in salary?

Mayor Beame. They did take a reduction in salary, they took a 2½ percent reduction in salary.

Mr. Kelly. Everybody in New York City took a 2½ percent reduction in salary.

Mayor Beame. Everybody who is in our pension system.

Mr. Kelly. At the same time they took the 2½ percent reduction in salary, did you give some of them a cost-of-living increase that amounted to 6 percent?

Mayor Beame. Only by productivity.

Mr. Kelly. But you did?

Mayor Beame. By productivity; in other words, they had to earn it by reason of greater productivity.

Mr. Kelly. Well, Mayor, there has been some problem, apparently, about the accuracy of your bookkeeping. And I would certainly sug-
gest that, based on the answer you just gave, that that concern about the accuracy can be more than justified.

Now let me ask you this: you said in your statement, quote, "It would be tragic indeed if Congress permitted this City to plunge back."

Well, weren't you one of those that was before this Congress in 1975 saying that if you got the bail-out at that time that you would not be back, that this would give you what you needed to get your act together? My recollection is—we have got a record; I think we can dredge it up.

Mayor Beame. I don't know the exact words I said, but my recollection is, I did not ask for the seasonal loans, I asked for Federal guarantees at that time, and the Federal guarantees I asked for were not limited to 1 month or a year or 5 years. I asked for the idea of Federal guarantees, and I asked it for the whole country, not for New York City alone, and under certain stringent conditions.

Mr. Kelly. But your suggestion now is that really the Federal Government is at fault for all of your problems, and that you don't have a bookkeeping system even to this day that anybody can tell anything about, and the fact that you are paying the highest salaries in the United States and you are bankrupt; you have no responsibility for that, and all of the rest of us are at fault?

Mayor Beame. No, we have in place one of the most sophisticated and modern accounting systems in the world at a cost of $16 million to $17 million.

Mr. Kelly. Well, is that the highest bill in world, the $16 million to $17 million?

Mayor Beame. I cannot give you that answer. But we have such a system in place.

Mr. Kelly. What about rent controls? Have you done anything to try to abolish this rent control system that has wreaked such devastation on your town?

Mayor Beame. No; because I am in favor of rent controls where the vacancy rate is below 5 percent, which is required under the law.

Mr. Kelly. Do you believe in the concept of private property?

Mayor Beame. Yes, sir.

Mr. Kelly. Private ownership?

Mayor Beame. Yes, sir.

Mr. Kelly. Thank you, Mr. Chairman.

Chairman MOONFELD. Mr. Hubbard.

Mr. Hubbard. Mayor, thank you for being with us, and thank you for your helpful testimony previously in Washington.

Regarding rent controls, wouldn’t you agree that the higher income property in the City of New York should have rent controls lifted from it because it does advantage the wealthy and the higher income groups?

Mayor Beame. As a matter of fact, that is the situation in the higher income properties. The properties built after 1947 are not under a rent control law, but under a rent stabilization law, and there is a rent stabilization board which makes the determination of the rentals based on the Bureau of Labor Statistics data, and then based on that, they vote on whether there should be an increase in those rentals. And so that procedure has been in place.
Mr. Hubbard. What about the Central Park area apartments, for example, which would be among the highest in value, real-estate-wise?

Mayor Beame. Those would be—well, it all depends on when the building was put up, but normally, I would say a lot of those are cooperatives, and so the question of rent control is not involved.

But I don't think there is any problem that I have heard from any landlords that own those Park Avenue apartments in terms of rentals.

Mr. Hubbard. And let me ask you this: have you done anything during your administration to increase the commuter tax?

Mayor Beame. We have tried, and we could use your help, if you could give it to us. We have tried that in the legislature. We have no power, as you know, under the constitution to levy any tax except a real estate tax within the constitutional limit which is already set. We have no power to levy any other tax unless the legislature approves. And I have gone up to the legislature every year that I have been here asking if they would increase the commuter tax to the level of the residents.

Mr. Hubbard. Why would the Legislature of New York—and I formerly served in the Kentucky Legislature—why would the Legislature of New York oppose increasing the commuter tax when, in fact, this would bring a revenue from people who live in Connecticut and New Jersey?

Mayor Beame. Well, let me put it this way: I presume that the legislators from Nassau County and Westchester and Rockland and all of the other bordering counties within the State believe that by so doing they would hurt their constituents. They represent them; they don't represent us in that matter.

Mr. Hubbard. But don’t these legislators agree—and apparently they don’t—that their constituents derive a great benefit from the City of New York?

Mayor Beame. That is what we argue, but if they agree, it is not done publicly.

Mr. Hubbard. Prior to your testimony, we had four financial experts here. All of them work in the City of New York, but none of them live in the City of New York. And they were giving us advice as to how to help New York City.

Mayor Beame. You know, Congressman, that is our problem. We have a lot of people who don't live in New York City, and we have some media people who don't live in the City and who tell us how to run our City and tell us what is wrong with it and criticize the administration. That is our problem.

Chairman Moynihan. Mr. Caputo.

Mr. Caputo. Thank you, Mr. Chairman.

Mayor Beame. I would like to cover a lot of ground. If we can go crisply, I would appreciate it.

First, let me clarify: You are not here today asking for aid, nor as I understand it, have you ever asked for aid; the accommodation you have from the Federal Government is one in which you borrow money at above the borrowing cost of the lender—the Federal Government—and the extension you seek is on the same terms?

Mayor Beame. That is right.
Mr. Caputo. And that you would be prepared to extend that to any other municipality from the Federal Government?

Mayor Beame. Absolutely.

Mr. Caputo. You are not seeking any aid that any other American isn’t entitled to, or have you ever?

Mayor Beame. That is true.

Mr. Caputo. And that is as true of your guarantee program, for which you will presumably pay some kind of fee as it is to the seasonal loans?

Mayor Beame. Exactly.

Mr. Caputo. Second, let me go back, and the purpose of this hearing is to review the seasonal loan program as it has worked to date. We will talk about other, wider programs at another hearing.

The dimensions of the agreement that we are now reviewing of seasonal loans; first, the City was expected to stop getting further into debt, and it has done precisely that since the seasonal loan program began. Indeed, if you consider MAC a State agency and not a City agency, the total City indebtedness has fallen from about $13 billion or $12½ billion to about $7½ billion. The City plus MAC is less in debt than the City was prior to the seasonal loan program?

Mayor Beame. That is true.

Mr. Caputo. The City was called upon to raise local taxes, and it did that.

Mayor Beame. That is right.

Mr. Caputo. The State of New York was called upon by the Federal Government to raise taxes to help finance the solution; and it did that.

Mayor Beame. That is true.

Mr. Caputo. The State of New York has extended new forms of aid since the beginning of the seasonal loan program, like the assumption of part of court costs; like the assumption of part of TAP?

Mayor Beame. Well, the City University.

Mr. Caputo. The City was called upon to ask its municipal employee unions to loan money to the City?

Mayor Beame. That is right.

Mr. Caputo. And they did that?

Mayor Beame. Now they hold approximately $3.5 billion to $4 billion.

Mr. Caputo. The State of New York was called upon to loan additional money to the City, and that has happened?

Mayor Beame. It has advanced it, for which we are paying the interest, by the way.

Mr. Caputo. There was some alarm about the pension levels. Constitutionally, it is pretty well settled, you can’t take a pension back once it is settled. But with respect to people who were hired after the Federal loan program began, they have substantially reduced pensions?

Mayor Beame. There is a new pension system. A new law has been passed setting up a new pension system for employees.

Mr. Caputo. For the first time, there is tuition at the City University?

Mayor Beame. That is right.

Mr. Caputo. The transit fare has been increased over 40 percent since the seasonal program began?
Mayor Beame. That is right.
Mr. Caputo. There has been a substantial reduction in the number of City employees?
Mayor Beame. That is correct.
Mr. Caputo. Some 67,000 social security numbers that used to be on the City payroll—
Mayor Beame. 61,000.
Mr. Caputo. I'm sorry, 61,000. Some of them have been rehired by other levels of government, like the State and like the CETA program coming out of Washington?
Mayor Beame. Exactly.
Mr. Caputo. But they are off the City payroll, as we are used to calling that term?
Mayor Beame. They are not paid with City money.
Mr. Caputo. Now that to me—and I, as you may remember, was in the State legislature when these deliberations began—is what the City and State agreed to do. So we are here today 2½ years later reviewing what was done and what was agreed upon. And we have substantially complied.
Do you think that is a fair statement?
Mayor Beame. Yes; and I want to compliment you on having all of—that list of things that we have to think a lot about to recall.
Mr. Caputo. Thank you, sir.
Let me turn to the more controversial items. Now there has been a lot of talk about wages here today. As I understand it, the average gross wage in June of 1975, citywide, was $16,000 in round figures?
Mayor Beame. That is right.
Mr. Caputo. Today that number is $18,000, 3 years later?
Mayor Beame. That is right.
Mr. Caputo. Now 60 percent of that increase, $1,200 roughly, is traceable to the fact that on the day the seasonal loan program began the City was under contractual obligations, legal commitments, to raise wages by that $1,200?
Mayor Beame. That is correct.
Mr. Caputo. The only way to get out of that would have been to break the law, and obviously, the Federal Government did not want us to do that.
Another 15 percent of that increment from $16,000 to $18,000 is traceable to the fact that we fired so many junior people that the residual people had more seniority; it is not a pay increase at all. You are just capturing the higher pay that a more senior person gets in the normal course of events. The balance, 25 percent of the increase, was a discretionary wage increase, but it was offset by compensating cost decreases, so that in that sense there has been no increase in city wages.
And Mr. Mayor, do you know what the rate of inflation was during the period of time when the wages were frozen in that manner?
Mayor Beame. I am not sure; I think it was in the neighborhood of 6 percent a year.
Mr. Kummerfeld. I believe the 3-year total exceeds 20 percent. We can supply that for the record.
Mr. Caputo. Well, I have 18.1 percent in front of me, and I am afraid my time has expired.
Thank you.
Chairman MOOREHEAD. Mr. Koch.

Mr. Koch. Mr. Chairman, I really have no questions.

I would just like to make a brief comment, and that is this: The current mayor leaves office with the affection of all of the citizens of this town. That is really extraordinary because the last mayor didn’t.

There is a great deal of affection. There may be disagreements; there are disagreements that have arisen over the years, political disagreements. But you have seen a demonstration of why he has had and has the nickname of “Spanky.”

Mr. Caputo. Mr. Koch, would you yield to me the balance of your time?

Mr. Koch. Yes.

Mr. Caputo. I wanted to explore one more of the controversial issues, and that is the budget balancing.

There was an agreement with the State of New York, pursuant to a statute, that certain items in the expense—capitalized expense items would be removed from the capital budget in an orderly way. Second, there was an agreement that by the time the seasonal loan’s first installment expired, this next spring, the City’s budget would be balanced.

Now, there has been a lot of controversy about the next budget. But in terms of that agreement, is it your view that you have reached a balanced budget in the current year, the year that will end this spring?

Mayor Brat. Well, of course, as you know, we still have 6 months to go. But there is no doubt in our minds that the rate that we are proceeding at, that we will have a balanced budget. And if we are able to accomplish the same kinds of results that we have in the 2 years past, especially because of our new system of controlling expenditures, we look forward to having a surplus.

To put it another way, a positive balance at the end between our revenue and expenditures.

Mr. Kelly. Would the gentleman yield for a balancing question?

Mr. Koch. Of course.

Mr. Kelly. Without regard to all of this business about the percentages and the cost of living and all of that, then and now, the public service employees in this town still are the highest paid in the Nation when you include their fringe benefits, isn’t that true, Mayor?

Mayor Brat. Not necessarily, Congressman. Let me just expand a bit on that. I think if you would take, for example, the certain uniformed forces, you will find certain cities are in excess of ours.

Mr. Kelly. Including the fringe benefits?

Mayor Brat. Yes.

Mr. Kelly. Do you have figures there, Mayor? And I wonder if I might see them. Are they the ones dated October of 1977?

Mr. Burton. Yes.

Mr. Kelly. Which category are you referring to, Mayor?

Mayor Brat. Well, for patrolmen.

Mr. Kelly. Now are you representing to this subcommittee now that these are salaries—or salaries including all fringe benefits?

Mayor Brat. I would have to ask the deputy mayor. He just handed it to me.
Mr. Kelly. And he says they are salaries; is that correct?

Mr. Burton. They are salaries.

Mr. Kelly. Well, I did not ask the question about salaries, and I did not want to be avoided by giving me something I did not ask for. Because what I asked for was salaries including fringe benefits. The total cost to the taxpayer. You are still the highest paid people in the United States without regard——

Mayor Beame. I could not answer that question without getting some data to find out what their fringes are in other parts of the country.

Mr. Kelly. It may not be a concern to you, but it is a concern to me, and I have checked. Thank you.

Mayor Beame. Congressman, it is a concern to me, too.

Mr. Caputo. If I can reclaim my time, Mayor Beame: Isn’t it true that at whatever level we are today, just about everything that could have legally been done to lower those costs, fringe and salary, was done?

Mayor Beame. I believe that is true.

Mr. Caputo. That to do more between 1975 and today would have been to violate the law, either the contractual obligations entered into by way of pension or salary agreements.

Mr. Hubbard. Would the Mayor-elect yield to me for just a moment?

Mr. Koch. I won’t have much opportunity to ever yield again on this subcommittee, so I am delighted to take advantage of it.

Mr. Hubbard. I would simply say to Mayor Beame that you will recall that I was one of those who questioned him extensively when he was in Washington for our hearings before our subcommittee. But I would compliment you on living up to your commitments that you laid out before us as we considered a financing plan for the City of New York. And you can know that even though there are critics and skeptics of this type of financing for New York from the rural areas of America, that indeed the fact that you have tried, as Congressman Bruce Caputo has listed the many examples of fiscal responsibility that you have tried to bring to the City of New York, you can also rest assured that although you and our colleague have been competitors in a mayor’s race, that our warm esteem and high confidence in Ed Koch and Herman Badillo could be the factor that gives Congress the confidence to assume financing for New York beyond June 30, 1978. We do admire you, Mayor Beame, but indeed we also admire our colleagues who leave us to come lead the City of New York.

Mayor Beame. Thank you very much.

Chairman Moorhead. Thank you, Mr. Mayor and your associates, for excellent testimony. We congratulate you on a job well done in living up to your commitments and wish you well in the future.

The subcommittee would now like to hear from the Honorable Harrison J. Goldin, comptroller of the City of New York.

**STATEMENT OF HARRISON J. GOLDBIN, COMPTROLLER OF THE CITY OF NEW YORK**

Mr. Goldin. Thank you very much, Mr. Chairman and distinguished members of the subcommittee.
I appreciate this opportunity to speak to this important congressional subcommittee about New York City's prospects for fiscal recovery and for achieving a permanently balanced budget.

Yesterday, I presented a plan to the Senate Committee on Banking, Housing and Urban Affairs, designed to help the City achieve fiscal self-sufficiency and recovery in 3 years.

Today, it is my privilege to ask the members of this Subcommittee on Economic Stabilization of the House Committee on Banking, Finance and Urban Affairs for their support of that 3-year plan.

Your hearings and those of the Senate committee are providing the Nation valuable information and offering a forum for discussion of issues that affect profoundly and directly the survival of our City. I hope the testimony of your witnesses will help America gain an insight into what went wrong, what the City has done and is doing to correct past fiscal mistakes, and most important, what still needs to be done by the City, the State, and the Federal Government.

I think it obvious by now that the City cannot do it alone, that the State and City cannot jointly do it by themselves, and that some further temporary involvement of the Federal Government is required.

The differences that have been expressed so far revolve around the nature, depth, and length of the Federal involvement and around concurrent actions which the State and City must take.

The one suggestion which must be rejected out of hand is bankruptcy. Not only would that be giving up the fight just when the reforms already achieved angular fiscal integrity in the next few years, but bankruptcy would plunge the City itself into chaos, with serious adverse repercussions elsewhere.

Because of this, we believe we are justified in saying that it is in America's interest, not just in New York City's interest, that the Nation's premier City, where 1 in every 25 Americans continues to live, be kept from going bankrupt. A necessary corollary of that is continued temporary Federal participation over the near term in our efforts to become self-reliant. I know the subcommittee understands that it took many years of what is now universally recognized as unwise management, financial and otherwise, for the City to dig the hole in which it has found itself. New York has made great progress in the last couple of years in extricating itself, but quite simply put, we need more time.

We are grateful as a City for past Federal and State help. Since the City itself has achieved much in correcting past mistakes, and more important, has met, on time or better, all the milestones contemplated upon enactment of the Federal Seasonal Loan Act in 1973, I would hope that the Congress will see fit to continue Federal help so that we may achieve the ultimate goal of self-reliance.

As you know, despite the hardships involved, in the aftermath of its crisis in 1975, the City increased taxes, imposed tuition fees at the City University, eliminated more than 60,000 positions from the City payroll, and achieved this year a technically and legally balanced budget. City finances have been subject to supervision by an Emergency Control Board. All Federal seasonal loans have been repaid on time or even ahead of schedule. The City in record time totally revised its accounting system and installed a sophisticated budgetary control
and management information system. The requirements of State law respecting the phasing of expense items out of the capital budget have been met and exceeded.

An extensive series of performance audits by my office have exposed and are continuing to expose examples of waste and inefficiency in the City’s management of its operation. The new mayor has repeatedly pledged himself to implementation of the myriad proposals for management improvements and economies that I have recommended.

You will recall that while the seasonal loan program was debated, the consensus then among City, State, and Federal officials, in the Halls of Congress and among financial institutions, was that if the City met all these milestones over a 3-year period, it would surely regain its fiscal health and its access to public credit markets.

It turned out that all of us were wrong. The Federal program was essential, of course, for the City to avoid bankruptcy; it carried the City over 3 critical years in which the milestones could be and were met, in which operational reforms were initiated.

But the Federal program, developed in 1975 to restore the City’s credit over 3 years, of which the Federal Seasonal Loan Act was such an important part, left certain credit problems open and unresolved: the annually recurring $800 million State advance to the City; the more than $600 million of operating expenses which are still in the capital budget; the status of future controls upon the expiration of the State Emergency Control Board on December 31, 1978. It is now clear that potential lenders will continue to regard these issues, until they are fully settled, as barriers to the extension of public credit.

Accordingly, in September, I proposed a plan to deal comprehensively and on an integrated basis with all of the City’s still remaining credit issues. I want to stress that this is not a plan simply to get us through the next 3 years, in contemplation of still another 3-year plan thereafter. I recognize that any further plan must be carefully and convincingly calculated to restore the City to full financial self-sufficiency by July 1, 1981.

Since I made this plan public in September, Senator Proxmire and Secretary Blumenthal have both made it clear that any plan calling for Federal participation must be self-contained, not depend on additional Federal action for its success, must involve financial self-sufficiency for the City at the expiration of the term and be based on genuinely balanced budgets on a permanent basis, must assure that upon completion of the plan the City will be able to meet its own credit requirements and must be based on additional State assistance to the City.

Accordingly, last week I proposed amendments to my September plan. The major elements of my proposal are as follows:

One, bonding out the $800 million rolling State advance over 3 years;

Two, phasing out borrowing for expense items within only 3 years;

Three, financing roughly $3 billion of long-term cash needs, including remaining capitalized items.

Four, renewing the Federal Seasonal Loan Act for 3 more years, but with decreasing loan limits each year, financing an increasing share of seasonal needs through public offerings of City notes. I might add that
the bonding out of the State advance will further reduce seasonal needs.

Five, tentative projections just developed by the City’s Budget Bureau are that the gap which must be bridged to balance the budget in fiscal year 1979 is at least approximately $400 million. An additional gap of approximately $450 million or more looms in 1980, bringing the accumulated deficit for those 2 years to $850 million. A projected imbalance of another $100 million or more must be corrected in 1982. Thus, looking ahead 4 years, the City faces the Herculean task of finding new revenues and making extra cuts to wipe out deficits that total almost $1 billion.

The restructuring of long-term City debt is a critical element of any plan under which the City will close these gaps and produce balanced budgets without fatally crippling itself in the process. To achieve permanently balanced budgets, the City needs the ongoing annual cash relief that would derive from stretching out the short, concentrated maturities on some $600 million to $800 million of its long-term bonds.

Six, accordingly, total City long-term financing requirements over the next 3 years aggregate approximately $4.5 billion. That comes from adding the $800 million in item one, the expense items in item two, the long-term capital requirements enumerated under item three. Of this $4.5 billion, the Municipal Assistance Corporation could provide half, or $2.25 billion, by public sale of its own bonds under existing first and second bond resolutions.

Seven, there is no current prospect of a successful public bond sale by the City itself. As the subcommittee knows, and as everyone has acknowledged, the City recently made a strenuous good-faith effort to re-establish its public credit on a limited basis. However, despite the extraordinary security features enacted by the legislature to make attractive the notes which were subject of the recent aborted sale, the banking managers informed the City that no firm underwriting was possible. While the underwriters said they would try to sell whatever notes they could on a “best efforts” basis, their refusal to give an underwriting commitment reflected their view that no market for City securities yet exists. Clearly, anything can be sold at a price. But when push came to shove, no underwriting was obtainable, even for notes enjoying extraordinary security features. And for those of you who follow closely the municipal bond markets, I would note that the last few days—including events today—established further eroding and deterioration in the market respecting New York City’s securities.

Since the State’s additional assistance can probably be more effectively provided in the form of load shedding arrangements and cash-flow improvements, the City must look to the Federal Government for assistance in securing the remaining $2.25 billion of the City’s long-term financing requirements not assumed by MAC. This assistance could come in the form of Federal guarantees of City or MAC debt, Federal purchase of $2.25 billion in MAC bonds secured by City bonds or through some other financing arrangement yet to be developed.

Eight, in exchange for such guarantees, the City would not only subject itself to long-term oversight by a monitor empowered to enforce balanced budgets, but it would also convenient the application of
certain cash proceeds from capital borrowings during this 3-year period. Acceleration of the phaseout of expense items from the capital budget would enable the City to take borrowed funds that would otherwise have paid for recurring expenditures and invest those funds during the term of the plan in economic development, specifically in capital projects certified by the Treasury as revenue-producing for the City, rather than revenue-consuming. This, too, would reinforce the City’s structural ability to achieve recurring balanced budgets on a basis that would permit a level of services sufficient to secure the City’s economic and productive base. In that connection, I would also propose that the City implement recommendations by the Temporary Commission on City Finances to provide substantial tax reductions to promote economic development.

Nine, and last, an important role of the State in this plan would involve its reform of its own budgetary and financing practices under which the largest share of State aid, over a billion dollars, is received by New York City in the final quarter of the City’s own fiscal year—creating each year a need for over a billion dollars in seasonal financing by the City. Reform of State aid schedules would improve materially cash flow not only for New York City, but also for all other municipalities and school districts in the State, many of which are equally hard pressed. State supported programs in such fields as health and mental health should be financed by the State in accordance with the rate of expenditures incurred by the municipality rather than 3 to 6 months after the fact. Education aid should be financed ratably throughout the school year rather than 75 percent in the last 3 months of the school year—which coincide with the last 3 months of the City’s fiscal year. The provision of State aid on a schedule roughly in balance with expenditures, as was the practice in the case of education aid prior to 1969, would give the City an improved credit position, materially reduce its need for seasonal financing altogether and provide close to $100 million a year in budget relief as the result of reduced short-term debt service.

I realize there is a reluctance to commit the Federal Government to a long-term loan to the City. However, I respectfully submit that this reluctance is unwarranted for a number of reasons: The City has faithfully adhered to all of the milestones that had been contemplated when the current 3-year financial plan was drawn up and put into effect; this second 3-year plan which I am proposing involves a phaseout of Federal seasonal loan help; this plan also calls for only one-shot long-term credit assistance.

If implemented, this new plan offers real hope that the City will fully recover its fiscal integrity, that it will regain full and direct access to the public credit markets, that all remaining credit issues will be resolved, and that Federal involvement in the City’s fiscal affairs can cease at the end of the 3-year period of the plan.

Thank you.

[Mr. Goldin’s prepared statement follows:]
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8. In exchange for such guarantees, the City would not only subject itself to long-term oversight by a monitor empowered to enforce balanced budgets, but it would also convenant the application of certain cash proceeds from capital borrowings during this three-year period. Acceleration of the phase-out of expense items from the capital budget would enable the City to take borrowed funds that would otherwise have paid for recurring expenditures and invest those funds during the term of the plan in economic development, specifically in capital projects certified by the Treasury as revenue-producing for the City, rather than revenue-consuming. This, too, would
reinforce the City's structural ability to achieve recurring balanced budgets on a basis that would permit a level of services sufficient to secure the City's economic and productive base. In that connection, I would also propose that the City implement recommendations by the Temporary Commission on City Finances to provide substantial tax reductions to promote economic development.

9. An important role of the State in this plan would involve its reform of its own budgetary and financing practices under which the largest share of State aid (over a billion dollars) is received by New York City in the final quarter of the City's own fiscal year—creating each year a need for over a billion dollars in seasonal financing by the City. Reformulation of State aid schedules would improve materially cash flow not only for New York City, but also for all other municipalities and school districts in the State, many of which are equally hard-pressed. State supported programs in such fields as health and mental health should be financed by the State in accordance with the rate of expenditures incurred by the municipality, rather than three to six months after the fact. Education aid should be financed ratably throughout the school year, rather than 75% in the last three months of the school year—which coincide with the last three months of the City's fiscal year. The provision of State aid
on a schedule roughly in balance with expenditures (as was the practice in the case of education aid prior to 1969) would give the City an improved credit position, materially reduce its need for seasonal financing altogether and provide close to a hundred million dollars a year in budget relief as the result of reduced short-term debt service.

I realize there is a reluctance to commit the Federal government to a long-term loan to the City. However, I respectfully submit that this reluctance is unwarranted for a number of reasons: the City has faithfully adhered to all of the milestones that had been contemplated when the current three-year financial plan was drawn up and put into effect; this second three-year plan which I am proposing involves a phase-out of Federal seasonal loan help; this plan also calls for only one-shot long-term credit assistance.

If implemented, this new plan offers real hope that the City will fully recover its fiscal integrity, that it will regain full and direct access to the public credit markets, that all remaining credit issues will be resolved and that Federal involvement in the City's fiscal affairs can cease at the end of the three-year period of the plan.

Thank you.
Chairman Moorhead. Thank you, Mr. Goldin, for an excellent and forcefully presented statement.

At one point in your testimony—I think it is page 2—you talk about the temporary Federal participation, and then on the last page you said, “Federal involvement in the City’s fiscal affairs would cease at the end of... 3 years.”

Is that consistent with your recommendation that the Federal Government, for example, purchase $2.25 billion of MAC bonds? Would that be for a longer period than 3 years?

Mr. Goldin. Mr. Chairman, my recommendation is that a Federal involvement during the second and last years of the 3-year plan be of a nature designed not just to get the City through the 3 years, but be of a nature designed to have an enduring impact on the City beyond the 3 years.

Therefore, I contemplate a Federal assistance in the restructuring of the City’s debt which would involve either purchases, or no less acceptably, guarantees, during this 3-year period, which would have an enduring impact 4 years thereafter.

And so the Federal assistance would be forthcoming during the planned period but would continue to have an impact and an effect 4 years after the planned period.

Chairman Moorhead. Well, your point No. 8 is that the City would subject itself to long-term oversight by a monitor. That would be a monitor whose existence would continue so long as the Federal Government held the $2.25 billion in MAC bonds; is that correct?

Mr. Goldin. And for that period and arguably longer, Mr. Chairman.

Chairman Moorhead. Well, I believe once the Federal Government gets out of the picture, which would occur if it could sell those MAC bonds, I certainly don’t believe the Federal Government needs to monitor.

I would, as I said in my opening statement, like to get New York City on its feet and off our backs. I am just wondering if you are not being optimistic in thinking that all that can be done in 3 years?

Mr. Goldin. Mr. Chairman, I would not contemplate that the monitoring mechanism would end during the 3 years or indeed would end for a considerable period thereafter. I am not contemplating either, necessarily, that the Federal Government would want to have a direct participation in the monitoring mechanism, whether during the 3 years or thereafter.

I am suggesting as part of my plan that the Federal financing participation, in one form or another, would occur during the 3-year plan, having an enduring impact for years after the 3-year plan.

The Federal role would be secured after the 3-year plan by several other features: First, the continuation of a monitoring mechanism on which the Federal Government would not necessarily have to have a representative but which would have powers and responsibilities that would be designed to assure the continuation of practices in the City which would be reassuring to creditors both during the 3-year plan and thereafter.

Second, I contemplate, Mr. Chairman—and this is an important point, so I hope you will permit me to add it—I contemplate that the Federal guarantees, if that was the form, would be secured by Federal
revenue sharing, so that the security of the Federal Government would be absolute and unequivocal.

Chairman MOORHEAD. Mr. Goldin, I proposed to Governor Carey, on this long-term proposition, that there should be a State—call it coinsurance if you like—but 50-50. And he backed away from that size. But he did seem to indicate that the State would consider this.

Would that work into your plan?

Mr. Goldin. Well, I would think that any coinsurance provision would have to take cognizance of the encouraging recovery of the State credit position. But nonetheless, in its precarious posture I think it would be in nobody's interest to involve the State, and to a degree which would jeopardize the credit liability of the State itself.

I have acknowledged the quite understandable insistence by a number of Federal spokesmen that the role of the State be increased materially. I have proposed a mechanism which, in my judgment, interposes the State in a way which benefits the City from a credit and budget standpoint very substantially and which at the same time has a positive impact on the credit position of the State as well.

An alternative arrangement involving coinsurance could have an adverse position on the State's credit position. And I think we would agree that if we went so far as to adopt a mechanism designed to involve the State, to jeopardize the credit position of the State, not very much would have been served.

Chairman MOORHEAD. My time has expired, but I hope some time you and I will be able to talk about this further. I think it will be a lot easier to sell if the Congress could be sure that the State is up there with us.

I recognize now the ranking minority member pro tem of the subcommittee, Mr. Kelly.

Mr. KELLY. First, it would occur to me that there would not be any real way to calculate the damage that is going to come to our Nation's economy if the Federal Government now starts and gives some kind of special treatment to assist a city, predicated not on any kind of merit but predicated only upon the fact that they have lived excessively, they have been irresponsible in their government, they have not maintained the books, they have violated the law in the way that they have operated their City in that they engaged in deficit financing that the law specifically prohibited; and that the only censure that would come to them from the Federal Government is that we are going to do something good for you because we want to encourage this kind of nonsense all over the United States.

Isn't that really what we are doing? And you are sitting there now recommending that to the Government, to the people of the United States, and to the people of your own city? Because that is what has happened, isn't it?

Mr. Goldin. I don't think I am, Congressman.

Mr. KELLY. Your town is bankrupt, isn't it?

Mr. Goldin. Would you permit me first to correct a misapprehension, if I may do that?

It is perhaps frustratingly true, but nonetheless true, that the City's financial and accounting practices over the years which have got the
City into trouble were not only legal, but were sanctioned by law at the highest level of State government.

Mr. Kelly. You mean that is on an after-the-fact basis?

Mr. Goldin. No, that is not correct.

Mr. Kelly. Didn't the law require that you people not engage in deficit financing?

Mr. Goldin. No, sir.

Mr. Kelly. It was all right for you to borrow money for your current operating expenses?

Mr. Goldin. The anomaly of State law, Congressman, was that it required a balanced budget, and then proceeded to define a balanced budget. And it defined how a balanced budget would be realized and achieved.

Mr. Kelly. When did they do that?

Mr. Goldin. That process began in roughly 1964. It continued almost annually thereafter through recurring redefinitions by the State legislature concurred in by the Governor—the Republican-controlled legislature concurred in by the Governor.

Mr. Kelly. When did they write that last page?

Mr. Goldin. That began in 1964; it ended in roughly 1974. The last chapter, which was written by the legislature in 1974, specifically once again authorized the City to borrow money to cover operating deficits.

Mr. Kelly. Might I ask you another question? On page 3 you said you legally balanced the budget. And I think, typically, on page 5, you said you genuinely balanced the budget. Now how many ways do you balance the budget in New York, and what is the difference between genuinely and legally?

Mr. Goldin. Let me explain the difference if I may, sir.

The plan that was contemplated in 1975, of which the Federal Seasonal Loan Act was a part, envisioned that over the course of a 3-year period the City would achieve reforms incrementally. The balanced budget that was achieved this year was defined at that time. It was not a balanced budget that would be accepted by generally accepted municipal accounting principles, but it was—

Mr. Kelly. It was that kind of balancing?

Mr. Goldin. It was a balanced budget that was accepted by the Congress, accepted by all of the participants in the plan, as reflecting such enormous progress from the morass with which the City started as to represent very considerable reform.

Mr. Kelly. So that the deficits were just filled in by kind of golden stars for effort?

Mr. Goldin. Well, that is flattering, but no, not this Goldin, other kinds of golden stars.

If I may complete the answer, the contemplation now is that the City should be required——

Mr. Kelly. But my question is, there is a difference between “genuinely balanced” and “legally balanced?”

Mr. Goldin. Yes. “Genuinely balanced” means balanced according to generally accepted accounting principles; “legally balanced” connotes “balanced” according to the contemplation of the 3-year plan when it was enacted by Congress.
Mr. KELLY. So when you say "balance the budget", we have got to find out which balancing act you are referring to?

Mr. GOLDB. Just like when I say red, you have got to know whether I mean Revlon or somebody else.

Mr. KELLY. OK, let me ask you this: It would seem to me, though, if an individual could just interminably get the Federal Government to loan him money, there would never be any need for responsibility.

Why would that be different if you are dealing with a municipality?

Mr. GOLDB. It isn't.

Mr. KELLY. Then let me ask you something: Would it be illegal for you people to ask the unions in this town to take a 10- to 20-percent cut in wages in order to bring the wage scale in New York City in line with the wage scales in other cities in the United States? Would it be illegal?

Mr. GOLDB. It would not be illegal, Congressman, to ask them to work for nothing.

Mr. KELLY. Then why would it be proper then for anyone to say that they had done everything legally possible when they have not asked the unions to take that kind of pay cut? We got that testimony here that they did everything legally possible.

Mr. GOLDB. Because it would be my argument, with respect, sir, that to assert that there are legally possible requests that are preposterous really ought not to enter into the discussion.

Mr. KELLY. So you think it preposterous?

Mr. GOLDB. To ask them to work for nothing.

Mr. KELLY. But you mean the same kinds of wages that the rest of us in the country work for, that you intend to send the bill to?

Mr. GOLDB. Quite the contrary, I believe that to ask for people to work for wages that are consistent with what the Federal poverty levels are, in conjunction with the local standard of living, is about all you can ask of people. And as you probably know, from examining our wage rates here, many of our employees on the municipal payroll in fact work for wage rates which are below the Federal poverty scale.

Mr. KELLY. Then what you say is, it is not fair to ask the people in New York City that work for a bankrupt town to work for the same wages that other people do in the United States?

Mr. GOLDB. I don't believe I said that, sir.

Mr. KELLY. Well, tell me what you said. I thought that is what you said.

Mr. GOLDB. My answer is: We have asked people to take effective wage cuts, but wage rates in the City need to be examined in conjunction with the cost of living in this City, and that established a very different picture than would be established simply by comparing the wage of somebody working here with the wage of somebody working somewhere else, since the cost of identical commodities would be dramatically different.

Mr. KELLY. But the cost of living here is due to your own doing, isn't it? High taxes and everything else, resulting therefrom.

Mr. GOLDB. There's no question—and I acknowledge it, Congressman—that many of the reasons that this City is in trouble results from its own fault. And the question is, whether the rest of the country and
others ought to take the posture that we ought to stew in our own juice, or whether, having been given the dramatic evidence of our willingness to reform ourselves, we should be allowed to continue with some help for a limited period in order to be able to stand on our own feet.

Mr. Kelly. Mr. Chairman, my time has expired, but I just did not want to acknowledge that they have made such a heroic effort.

Thank you.

Chairman Moorhead. Mr. Badillo.

Mr. Badillo. Thank you, Mr. Chairman.

I want all of the members to know that Mr. Goldin has been a member of the Emergency Financial Control Board, and it has been his work over the past 2½ years that has helped to bring about the efforts on behalf of the City that Mr. Caputo was talking about. Also, he was not a part of the problems that began in 1964 because he came into the office of comptroller only 4 years ago.

But he does know the problems of the State legislature and the difference in a legally balanced budget and the accounting process for a balanced budget because he was a member of the State legislature, as senator from my district in the Bronx, and he had been familiar with those problems.

Mr. Goldin, would you like a chance to finish your answer on the procedures in the State legislature?

Mr. Goldin. Thank you very much, Congressman Badillo.

I think it's important to understand that over the course of many years—and I think there is no question that New York State and New York City went further in this regard than other localities—but that many communities in the country have been permitted to define a balanced budget in terms that we now understand do not reflect generally accepted municipal accounting principles.

Now I dare say that if we examined many of the jurisdictions represented on this subcommittee or in the Congress, certainly you would find that generally accepted municipal accounting principles were being violated in the determination of a balanced budget.

Nonetheless, so long as State law describes a balanced budget in terms that don't meet generally accepted municipal accounting principles, for legal purposes, those budgets are considered balanced.

What happened to New York over a period of years was that, starting in 1964, the legislature almost each and every year, legislated deviations from generally accepted municipal accounting principles; in effect, it determined that those deviations would still be consistent with the requirement of a balanced budget; and it thereby permitted and encouraged the City to borrow to cover its operating deficits.

Mr. Badillo. And isn't it a fact that that is exactly what the Congress of the United States did 2½ years ago? Some of us pointed out to the Congress then, that the so-called balanced budget that Congress was legislating included expense budget items in the capital budgets. So it should come as no surprise at all to anybody who was in Congress in 1975 that this issue now arises, as in the process of planning for a balanced budget in New York City, everyone knew that revenue included expense budget items that were in the capital budget. And that is one of the reasons why we are coming back now, and why we need
additional time to clear up an item which some of us warned 2½ years ago would have to be cleared up.

Mr. Goldin. That is absolutely correct. And let me say that the graveness of the City's request, or at least my plan would be, that the Congress not repeat the mistake that we all made. The mistake was not in saving New York City from going down the drain with the unforeseen, potentially horrendous consequences that that could have entailed, but rather in not developing a plan which would have dealt fully with all of those questions.

What we are now saying is, we are not coming and asking for a bandaid to get us through for 3 years, which I guess we always could do, but rather with a more fundamental solution that would enable us to use the time to effect further reform and repair, calculated to deal with all of our outstanding credit issues. And that is why we are seeking the kind of limited help during this period that is designed to have an enduring impact at the expiration of the planned period.

Chairman Moynihan, Mr. Caputo.

Mr. Caputo. Thank you, Mr. Chairman.

Mr. Goldin, I was heartened by your comprehensive analysis of the next 4 or 5 years. I think it is very useful.

Now, as I understand your testimony, you feel that there will be something like, in the following 4 fiscal years, a $400 million and a $450 million deficit, followed by a balanced budget, followed by a $100 million deficit. Is that what you said?

Mr. Goldin, I simply wanted to report to the subcommittee, Congressman Caputo, that these are figures which have been developed by the mayor's Bureau of the Budget. They are tentative figures, but they are current tentative figures. Those figures have only become available in the last 2 days, reflecting the most recent thinking on the tentative basis of Budget Bureau analysts. So, I wanted the subcommittee to have them. They are not definitive figures. They are relatively conservative figures, but they are, at least, the latest that are available.

Mr. Caputo. Do they include a 5-year phaseout of expense items?

Mr. Goldin. Yes; they do.

Mr. Caputo. Now, that gives rise, in addition, to a $3 billion capital project, over that period of time, to a $4½ billion long-term financing problem. Is that what you have said?

Mr. Goldin. Well, the $4½ billion financing problem is conceptually separate and distinct from the budgetary balance and deficit problem. I know you understand. So, there is a financing problem of significant proportions, but a financing problem.

Mr. Caputo. Now, wait a minute. You are going to bond those deficits, and that is included in the $4½ billion?

Mr. Goldin. No, sir.

Mr. Caputo. How are you going to finance the deficits?

Mr. Goldin. The deficits are obviously going to have to be covered through the ordinary process of balancing the budget. They are going to have to be covered either by increasing revenues or reducing expenditures, and there is no contemplation that those budgets not be genuinely balanced. Indeed, the contemplation now is that, instead of the earlier conception when the Congress first acted, that the City would have 10 years in which to achieve what I call, for shorthand, a
genuinely balanced budget, or what I would call, to be more precise, a
budget balanced according to genuinely accepted municipal accounting
principles.

I am now proposing that that objective be achieved, not in a
10-year period, but rather in a 6-year period, or, in other words, in
another 3 years. And my contemplation would not be that, despite
the magnitude of these problems—and they are enormous—that the
City get back into the rut from which it has climbed out, of borrow-
ing to cover operating expenses.

Mr. Caputo. So, your recommendation is that the City balance its
operating budget, which would not happen without further actions
and raise $4 1/4 billion of long-term money to build a capital construc-
tion program, to finance the advance from the State and to capitalize
the expense items now in the capital budget.

Mr. Goldin. One of the purposes of the $4 1/4-billion capital program
that I have presented is to have an impact upon the City's budgetary
problems. In other words, if you are dealing with deficits of this
magnitude, recurring, as these figures suggest——

Mr. Caputo. But you are suggesting to eliminate them.

Mr. Goldin. I am suggesting to eliminate them.

Mr. Caputo. And not to finance them?

Mr. Goldin. That is quite correct. But I am suggesting a method
of dealing with the City's existing burdensome, onerous debt structure,
designed to have a favorable impact on the expense budget problem
by reducing debt service requirements.

Mr. Caputo. Could the State legislature authorize MAC to issue
more debt and could MAC issue more debt than the $2 1/4 billion you
talked about?

Mr. Goldin. Under existing first- and second-bond resolutions, no.

Mr. Caputo. I mean the third resolution.

Mr. Goldin. It is conceivable, but the credit that would be involved,
the security of the revenues, the viability of the security, would prob-
ably weaken very materially the quality of debt and would result
in costs of financing to the City that would be excessive.

Mr. Caputo. Well, could the State create or attach some new stream
of revenues to improve MAC in that way?

Mr. Goldin. Well, it is hard to imagine, Congressman Caputo, that
the streams of revenue of high quality sufficient to sustain significant
borrowings can continue to develop and be earmarked for the benefit
of specific bondholders of MAC without undermining overall the
credit position of the City at the expiration of the 8 years.

Mr. Caputo. How about the pension funds? Could they participate?

Mr. Goldin. Well, as you know, the City pension funds have already
participated to the extent of about 37 percent of their holdings, and
the City has been in the anomalous position of having been criticized
by the SEC and the Congress for having overextended the exposure
of the pension systems to municipal- and City-related securities
already.

Mr. Caputo. Let me ask one last question. As I understand the
Emergency Financial Control Board, of which you are a member, they
have to authorize any expenditure not in the approved financial plan.
Now, I don't remember any of the City councilmen talking about pay increases before the election, when the approved financial plan was imposed, and hence it is that trivial in an economic sense, but dynamite in a symbolic sense—could not have possibly been in the approved financial plan, and as a matter of law must be reviewed by the Emergency Financial Control Board. Is that accurate?

Mr. Goldin. Yes, and no, Congressman Caputo. The question of review is what leads me to say "Yes and no." The City has the option of amending the financial plan, and so long as the aggregates, the totals of expenditures—contemplated expenditures and contemplated revenues—the aggregates in the financial plan, as adopted or as modified at the insistence of the City, are in balance, the Control Board accepts and under the law must accept the alternative of a balanced budget so that review would be limited to the question of whether the proposed modification to the financial plan was offset by other elements sufficient to enable the financial plan to continue to remain in balance.

Mr. Caputo. This expenditure isn't sufficiently extraneous to justify Control Board review, even if there are offsetting cost reductions?

Mr. Goldin. I don't believe that is true. I believe that any increase in proposed expenditures would require a modification of the financial plan, and a demonstration that the proposed budget modification had been offset in whatever way the City proposed sufficient to keep the City in balance.

Mr. Caputo. If the mayor or mayor-elect were to stipulate that it is without the financial plan—was not included in the financial plan, would that make it reviewable and overruvable by the Control Board?

Mr. Goldin. Well, if you are asking whether the mayor could ignore the legal process of adoption of local law—

Mr. Caputo. No; I meant to say, would his stipulation trigger review by the Control Board?

Mr. Goldin. I don't believe so, Congressman Caputo.

Mr. Caputo. If I could just close with a question—not a question, but a 15-second statement. The reason I was concerned was, I went to Washington earlier this week, after the council pay increase, and the 24 to 50 Congressman that I had carefully cultivated for 12 months and I thought were favorably inclined to our problem, had lost a good deal of confidence because of this pay increase, and if there is something that can be done, I think it would be very beneficial to our future in the Congress.

Mr. Goldin. Well, if I may add, Mr. Chairman, I share your view, so well expressed a minute ago, Congressman Caputo, that Government engages in and acts both in substantial and symbolic ways and that this is a symbolic act that is inopportune, to put it mildly. And it is for that reason that I oppose these pay raises and share your concern about the effect that they would have on a variety of issues that are of fundamental concern to the City.

Mr. Caputo. Thank you, Mr. Chairman.

Chairman Morrill. Mr. Koch.

Mr. Koch. Mr. Chairman, I regret that I was not in the room when the comptroller gave his testimony. He and I meet regularly, so whatever he said to you is not new to me.
He is one of the ablest public servants in the City of New York, and I am sure that the information he gave was helpful to the subcommittee.

I also want to say that he and Carol Bellamy and I are part of the new team. He is a link with the current administration only in the sense that he has information that he can bring to the new team. But he is part of the new team, and we are working together.

Chairman Mooniehan. Well, thank you very much, Mr. Goldin, for an excellent statement. We appreciate it deeply.

Mr. Gordon. Thank you.

Chairman Mooniehan. The subcommittee of a legislative body would like to hear from our fellow legislators of the State of New York. We would like to hear from the Honorable John J. Marchi, who is chairman of the Finance Committee of the New York State Senate, and the Honorable Arthur J. Kremer, who is chairman of the Committee on Ways and Means of the New York State Assembly.

I say this is an extraordinary panel because it covers both houses of the legislature and both of the major political parties, and it is, I think, an example of what I hope this subcommittee will follow, and our opposite numbers on the other side of the Capitol in Washington.

We appreciate very much both of you being willing to sit together as a panel. We would like to start, I think, with you, Senator Marchi, and then we will hear from Assemblyman Kremer, and then the subcommittee can direct questions to both of you.

Senator Marchi.

STATEMENT OF HON. JOHN J. MARCHI, CHAIRMAN OF THE NEW YORK STATE SENATE FINANCE COMMITTEE

Mr. Marchi. Thank you, Mr. Chairman.

I want to acknowledge my appreciation. I am sure it is a sentiment shared by my colleague, Mr. Kremer, that you have extended your auspices to both of us—a chairman of the assembly ways and means committee that is under Democratic auspices, and I am chairman of the senate finance committee which is under Republican auspices.

Chairman Mooniehan. Senator Marchi, could I interrupt just for 1 minute? A number of other assemblymen and senators have asked to testify, and would you please convey to them my apologies. We had to limit this to 1 day of hearings, and we could just have you two, as leaders.

Mr. Marchi. We appreciate that fact, and certainly within the circumstances that are controllable, the fact that you are here and willing to listen is evidence of the fact that you have not prejudged, and that is a source of comfort.

And I also wanted to thank the members of your staff, especially Mrs. Wallick, who was most cooperative and most helpful in making these arrangements.

I will synopsize, for purposes of brevity, the prepared text which I submitted.

I would like to point out that the deficit in 1975, at the end of July 1975, was on the dimensions of $5 billion, according to the Securities and Exchange Commission. A combination of adverse factors caused
this: the flight of middle-income families, vast migrations of poor to New York City from other parts of the Nation, the emergence of heavy concentrations of elderly and other medically needy in the City of New York.

These demands on the City’s social services resources came as the City’s capacity to pay for them was shrinking. During the 1960–75 period, many of the elderly were not able to exercise the options which were available to younger people by reasons of choice and by reasons of financial circumstances.

As a result, the population of senior citizens increased from 10.4 percent of the City’s population to 13.2 percent, a very steep rise as compared to the rest of the country where it has remained fairly stable, with only a very minor increase. So that the demographics of poverty in the City of New York consist of, to a great part, unemployables, that second tier described in the President’s program, the aid to dependent children, and the elderly.

We have had to budget—to make greater budgetary arrangements and provisions for this growing welfare problem in the City of New York, and I would like to point out, for instance, that in 1975—and the figure is even higher now—the per capita payment and tax on City residents for welfare is in the amount of $240 per person. Outside the City of New York and within the State of New York, it is only $60. And in Texas and Mississippi, it is less than $4, Mr. Chairman.

So, you can readily appreciate the profound convulsive impact that this demographic change has had on the City of New York.

There are a number of sins, Mr. Chairman. I ran for mayor on two occasions—1969 and 1973—and I pointed out a lot of these problems, and they are not a question of deficit financing, but continuing a number of services that were unsupportable in terms of city revenues. As a matter of fact, one of our columnists said that by media I was literally quarantined as a mad dog for pointing some of these facts out, but circumstances unhappily did indicate that we were indeed embarked upon a very perilous fiscal path.

We had a lot of discussion on questionable practices. They weren’t inflicted by Republican legislature or Democratic legislature. Many of these practices continued in bogus receivables, estimating—and this was a practice that was encouraged and abetted by the investment fraternity here in the City of New York—receivables that simply were not there and money was borrowed against that.

It was constituting a legal compliance, but, in effect, nonrecognition that these receivables certainly could not be justified on any legitimate or fiscally sound basis.

Now, what has the City done to help itself during this period? They have embarked on an 8-year program to phase out all shadow areas of capital expenditures, operating expenditures that are now carried in the capital budget. And the proposal advanced by the Governor which has, in effect, the support in principle by both Mr. Kerner and myself and our respective houses, to phase this out on a shorter period, on a 3-year period; so that we don’t have this as a perpetual emergency, is a step in the right direction.

There has been a limiting of growth in expenditures over which the mayor has control, and 60,000 people have been separated from City
service. And as I say, the so-called bogus receivables and questionable accounting practices—certainly great progress has been made, and I think it may be an exemplar at this point for the Nation.

What has the State done? We are phasing in a State assumption of the costs of the operation of the City University which had a separate tradition and a separate funding system; assumption of local operating costs; short-term aid to the City of New York; an assumption in part of the elimination of the stock transfer tax, which was not a step which we took willingly, but it was either that or lose the stock exchange and the great generative effect that it has economically in this City.

Two-thirds of our revenues go back to the community in the form of local assistance, and over 70 percent of our welfare expenses, of course, come from the City of New York.

We have created the Emergency Financial Control Board. I believe it should be continued. And of course, we created the Municipal Assistance Corporation, and we adopted the City Revenue Act just a month ago.

I opposed it, Mr. Chairman, at that time, because I felt that the premises did not exist for the City to go back to the market. And there was a penalty, Mr. Chairman, and I would say that anything that you do—that you hedge against this.

We did not have a truly balanced budget, the question of operating expenses still being part of the budget. We did not have that circumstance under control. There was the uncertainty of seasonal loans, and I felt that the premises did not exist for an appeal or an appearance on the market for the sale of budget notes.

I was proven correct. I was 1 of 5 in my house that voted against this, and I said that we should not have done it, and I believe that there has been damage in the amount of millions of dollars in the State of New York by the adoption of this act, which ironically was purporting to implement the dictates of the Treasury Department in Washington. I am not sure that they have these facts well in mind.

I say there was damage to every subdivision of the State of New York because it had to have adverse psychological effect when they, in turn, had to and will have to go to market with their notes, and we can tell you, Mr. Chairman, that in 1975 we had school districts in the State of New York with AAA ratings that were unable to go to market simply because they bore the imprint of the State of New York on it, and their budgets were solid, as was the State.

These are the adverse effects of insisting that the City go back when it is not ready to do so, and I proposed then and I propose now that perhaps we require as a matter of law that you should do that in any negotiations that proceed on this, that there be the concurrence of the Chairman of the Federal Reserve Board—some control so we don't precipitate the City and the State into needless expense and the futile gestures that we engaged in.

And most importantly, Mr. Chairman, the redemption of the promises by the President of the United States who, in my presence at the Alfred E. Smith dinner before 3,000 people—and Cardinal Cooke was there—the Governor had a little difficulty remembering whether this promise was made; I am sure Cardinal Cooke would verify my
version of it. He said, after President Ford had addressed the assem-
bliage—he said, “Friends, I will never tell the City of New York to
drop dead.” And there were heroic statements made about America’s
No. 1 economic problem is our cities and also the promise to equalize
the welfare burden of this country.

We placed a great deal of credence in Presidential promises, and,
indeed, he carried this State, and he carried the vote of the majority
of the American people on these promises. But where are we? They
have been rolled over until 1981, at the earliest. And believe me, I
don’t believe you are going to solve the problems of the urban centers
just with loans alone. There has got to be greater Federal involvement
in this problem. Meeting human needs, whether you do it and/or wel-
fare—greater equalization of welfare; reforms nationally—the equili-
brization of that burden; whether you do it by a greater assumption of
true capital expenditures in some of the urban districts—areas of this
country that are undergoing severe distress in their inability to renew
their capital plant.

Now, the States—New York State is doing the things that our
spiritual and moral values have taught us to do. We are trying heroic-
ly to meet the problems of the indigent here in the City of New
York and in the State of New York and in many of the northeastern
States.

I don’t accept very happily the pious lecturing from any States that
exert less than that kind of effort, where people are kept lean and
hungry and just strong enough to make it to those States, so that the
problem of the United States of America, of human distress, is resolved
in the City of New York and in the State of New York, and I believe
that we are entitled to equalizing and sharing in this burden around
the country. Otherwise, it doesn’t make sense. It is inconsistent with
our oaths of office, and I am sure that all of you being God-fearing
men and God-fearing persons recognize the fact that we have this
obligation to the poor of our Nation and that all of the burden not be
inflicted on these great urban centers.

Mr. Chairman, the growth in the budget of the City of New York
from 1975 to 1978 has been in the amount of 4 percent. Considering
energy needs and other needs, this has been very minor, but the growth
in welfare expenditures has been over a billion dollars—or 25 percent
in just those 2 years—2½ years. Thirty-five percent of the City budget
goes into welfare. So I submit, Mr. Chairman, that these are consider-
ations which should actively engage your human impulses, your con-
science, and the fact that we are one Nation.

There is a Presidential promise which we don’t like to consider as
mere campaign rhetoric, and we desperately need this assistance. We
are making every conceivable effort, including the policy of being the
highest-taxed State in the Union, to sustain human dignity.

I know you can regale me with what the City council has done. I
could not deplore it more. It was an act of cowardice. It was an act of
arrogance. And to have done it after the elections were over is just
simply unspeakable.

But we can’t inflict the sins of these people on the 8 million people
that live in the City and on the State of New York, and we can’t in-
flict it on the aging who are living at the ragged edge of poverty and
suffering in this City, because believe you me, Mr. Chairman, even at the so-called high champagne-and-caviar levels of support that we give to our poor in this City, they are not living that way at all. It is hard and very difficult living.

So, we know that the human impulses and your consciences are strong. We ask that your mind and your heart be joined in a policy that will reach out and help the City of New York.

[Mr. Marchi’s prepared statement follows:]

REMARKS BY HON. JOHN J. MARCHI, CHAIRMAN OF THE NEW YORK
STATE SENATE FINANCE COMMITTEE

Chairman Moorhead, members of the subcommittee, permit me to express my thanks and those of the members of the New York State Senate Finance Committee for permitting me to testify today.

The critical state of New York City’s finances has engendered your attention and that of your colleagues in the House of Representatives in a direct way for nearly three years now. And we are appreciative of the helping hand extended to New York.

It was in March of 1975 that New York City’s fiscal house of cards collapsed. Unhappily, this came as no surprise to those few of us who had warned for years previous that the practice of spending money it did not have would plunge New York into chaos.

Believe me, Mr. Chairman, I take no satisfaction from the validation by actual events of the warnings I raised in 1969 and again in 1973 during two mayoral campaigns and on countless other occasions as a State senator.

As chairman of the New York State Senate Finance Committee, I have been intimately involved with the most recent crisis since it erupted in 1975. When the smoke had cleared in March of that year, it became readily apparent that the City’s finances were in a state of affairs that local governments had not experienced since the Great Depression in the 1930’s.

It has been estimated that at the end of its fiscal year 1975, the city of New York’s poor accounting practices had produced a deficit, placed by the Securities Exchange Commission in its August 26, 1977, report, at more than $5 billion. The causes of the City’s plight have been well documented over the past 35 months. However, because you are here today to chart New York City’s current health, I believe it pertinent to examine briefly the developments that pushed the City into such shocking fiscal imbalance.

The City’s fiscal breakdown emerged as the inevitable result of adverse demographic and economic developments, the City’s expenditure policy and its reckless and short-sighted infatuation with fiscal gimmickry.

The City has been hit by a cataclysmic exodus of middle-income families even as the vast migrations of the poor to New York City from other parts of the nation and its territories have made it necessary to increase social service expenditures. Not only the settlement of a massive population of the poor but the heavy concentration of the elderly and other medically needy have strained the City’s social service resources at a time when its capacity to finance such expenditures was shrinking.

For example, from 1960 through 1975, it became clear that the senior citizens, whose medical needs are more frequent and substantive, were not joining in the movement out of the City, perhaps because of lack of wherewithal or will, or both. During the 1960–1975 period, the 65-year and older age group rose from 10.4 percent of New York’s population to 13.2 percent—while during the same period the nationwide average of citizens in that group increased only to 10.5 per cent. Welfare burdens in New York City generally averaged $249 per capita in 1975; $20 in New York State outside New York City and less than $4.00 in Texas and Mississippi (John P. Keogh, Regional Plan Association President, Journal of the Institute of Socio-economic Studies, December 1977).

Economic factors, often beyond the control of the City, have eroded New York City’s once thriving financial base. The relatively recent phenomenon of recession, coupled with severe inflation, recently called stagnation, has dealt harshly with the budgets of many urban centers throughout our country. Recession coupled with inflation hit New York most dramatically by requiring it to make
more expenditures for social services while decreasing the revenues needed to pay for those expenditures.

This nation's most recent recession made doubly clear the close relationship between the state of the national economy and the financial stability of local governments.

New York City's historic policy of being relatively generous in the services it provides was well intended but proved in the long run to be far too costly.

There is no doubt that the City's reliance on fiscal gimmicks not only delayed the day of reckoning but also served to further aggravate an already rapidly deteriorating situation.

This is history. What has the City done to help itself?

As we approach the end of the City's three-year financial plan, we see that the City has made some encouraging gains toward its goal of a balanced budget but further belt-tightening and further sacrifices lie ahead. Specifically, the City:

- Seems to be making some progress towards its goal of eliminating operating expenditures from its capital budget.
- Has managed to achieve some momentum in its effort to minimize the growth in expenditures—some of which are often beyond the control of the City, such as welfare, energy, blackouts, floods, to name a few.
- Has implemented changes in its budgetary and accounting procedures which are eliminating the unsound fiscal practices of the past, such as utilization of bogus receivables.

While managing its own fiscal crisis, the State has provided much needed assistance to New York City on an increasing scale. It will continue to do more, but fiscal circumstances place limitations on this possibility. Indeed, the State has found it necessary to ease the tax burden on its taxpayers, as a needed first step toward revitalizing its own sluggish economic base.

It has been reported that some have taken issue with proposals for a tax reduction in New York State—proposals on which there is general agreement between Governor Carey and the State Legislature. As we see it, the tax relief route is an indirect form of aid to New York City and other urban centers to help create jobs and reduce welfare costs.

It has long been proven that government alone cannot solve welfare and other social problems through a direct infusion of dollars. Private enterprise must become a willing partner if we are to achieve a permanent and stable solution.

Nonetheless, the State of New York has assumed a larger share of the cost of operating the senior colleges of the City University. This State has implemented a program to take over the local cost of running the court system. The State provided much needed short-term aid to the City in the early stages of the fiscal crisis.

The State has advanced $800 million in short-term money to the City each year since the early stages of the crisis.

The State of New York has implemented a new system of medicaid payments which should reduce the cost to local governments. And when it became apparent that the Stock Transfer Tax had to be eliminated to keep the stock exchanges in New York competitive with others around the nation, the State assumed part of the City's revenue loss.

Overall, nearly two-thirds of all the revenues New York State collects are sent back to municipalities as local assistance—and not used for State operations. Almost half of this local assistance money goes to New York City. In the area of welfare, more than 70 percent of the State's financial outlay for local assistance goes to New York City.

In addition to providing direct financial assistance to New York City, the State has supplied other important support by setting up such mechanisms as the Emergency Financial Control Board (EFCB) and the Municipal Assistance Corporation.

When the EFCB was created, the Legislature contemplated that a control mechanism for New York City would exist until a given period, six months, after the objectives of budget-balancing and related goals had been accomplished. Although it appears that a balanced budget may be achieved this year, prospects for continued balance appear to be uncertain at this time. While we obviously do not want to continue the EFCB into perpetuity, for the same reasons that we established the policy then, we are committed to continuation of a control mechanism for so long as may be necessary.
Recently, the New York State Legislature approved measures designed to strengthen the guarantees behind the City’s Revenue Anticipation Notes. This was done in compliance with Federal demands that the City show bona fide effort to reenter the bond market. The objective was to enable the City to present to the market securities designed to instill investor confidence in the City’s notes.

I opposed this legislation at the time on the grounds that the premises for a successful sale were absent.

The attempt by the City to reenter the market was unsuccessful. That abortive effort brought home three points. The first is that the City still has not achieved a truly balanced budget. The second is that without a continuation of the Seasonal Loan—or some other form of Federal guarantee—the City will in all likelihood be unable to meet its legitimate cash needs. The third is the need to restructure the decision-making so that there is adequate consultation with Federal representatives before any further embarrassments occur.

The forced cancellation of the New York City note sales was inevitable once Moody’s had issued its negative rating and evaluation concerning the City’s credit standing. This blow, coming amid press reports about the size of the City’s potential deficit for the 1978-79 fiscal year, weakens the prospects that the City will be able to issue its own notes after the present seasonal loan expires. Without continued federal financing of this nature, the City simply would have inadequate cash to meet its obligations on a current basis.

A federal decision to withhold renewal of the seasonal loans would be interpreted by most New Yorkers as a kind of “Drop Dead” reaction from Washington. In light of President Carter’s pledges, made in New York City in 1976, that he would never permit New York to “drop dead,” the State legislature looks to Washington for redemption of that pledge which can only be equated with an increased financial role by the Federal Government.

That is to say that renewal of the seasonal loans, in place now for two and one-half years, is essential, but is still not enough. Other forms of long-term assistance are equally important and chief among considerations for an increased federal role is a complete takeover by the Federal Government of the local share of welfare costs. For the hard fact is, that no matter what we in New York have done—in the Legislature, the office of the Governor, and in the City Administration itself, New York City’s welfare costs continue to mount.

For example, from 1975 through 1978 the City’s budget is rising from $12.9 billion to $13.5 billion, an average annual rise of four per cent. During that period welfare costs in the City are growing by almost $1 billion, or 25 per cent, from $4.9 billion to $4.9 billion.

In the current fiscal year (State) the projected costs for welfare alone account for almost 25 percent of the New York City Budget.

Such costs stem directly from a constant effort to provide basic services at humane levels to those less fortunate in our society. Granted, responsible individuals and groups may agree as to the level of support any government should attempt to maintain for the poor. Not even the Federal Charter on which the national program of public assistance is based defines the limits of society’s concern for humanity. Thus New York State and New York City have had little choice except to provide programs of welfare at a level consistent with our spiritual and humane traditions, faithful to the charters on which our governments are based.

Yet we also grant that fiscal necessity forces us to reexamine our efforts, perhaps to even revise our judgments as to the levels of support which can be fairly borne by a single taxpayer segment of our society. That task, now enduring for over those years, has begun to show results. Indeed, spiraling welfare costs have begun to show down. But this is not the place to audit that effort. But, I submit, this is also not the time to arbitrarily penalize the unfortunate and the destitute over whom fate has given us custody. Rather, it is a time to continue to meet those obligations in the best way that we can, even as we move to make the changes which have become necessary.

The welfare revisions advanced by the President, now known as the Carter Welfare Reform Bill, are symbols of the President’s promise of help to the beleaguered cities of America. However, in our judgment, they are more symbolic than substantive. They would deliver too little too late, if the President’s timetable for action is to be accepted.
We need help now. And while the President's bill has only been proposed, it
is a sign to us in New York that the President intends welfare relief for our
cities. In its present stage, the bill stands only as a proposal before Congress. But
it has already been regarded by New York City fathers as a symbol—a promise
to be seized upon, a presidential lifesaver, if you will, for a city that is drowning.
We must look to it as a promise of help now in our time of need.
Welfare relief need not be the only form of long-term assistance which should
be considered.

Other possibilities should include a public works program designed to main-
tain and revitalize our urban centers. New York City, for example, badly re-
quires widespread repair work on its streets, the bridges, its subways and a
myriad of brick-and-mortar public projects.
I respectfully urge your serious consideration of the appeals made today and
your concurrent understanding that New York's plight is a national problem,
with potential for affecting the lives of all Americans.

Thank you.

Chairman Moorhead. Thank you very much, senator, for an excel-
 lent statement.

We would now like to hear from you, Mr. Kremer.

STATEMENT OF HON. ARTHUR J. KREMER, CHAIRMAN, WAYS
AND MEANS COMMITTEE OF THE NEW YORK STATE ASSEMBLY

Mr. Kremer. Chairman Moorhead and Congressmen Caputo, Kelly,
and Koch, I appreciate your kindness in inviting us here today, and I
realize that at this late hour indeed, it may be difficult for everything
that we have to say to perhaps have the same kind of weight, were
it 9:30 in the morning, but I am sure you will give what we have to say
its due weight and recognition.

I will say this, that your kindness in inviting us here today preceded
any invitation that we had from the U.S. Senate, and the fact that
Senator Marchi and I testified Wednesday in front of Senator Prox-
mire's committee was actually a followup to your very gracious invit-
ation to be here. I think that has, of course, been a major failing in
many of the congressional committees, in that the people who are
elected to office and who make a lot of the hard decisions and have to
get the votes and round them up in order to make harder decisions are
sometimes neglected when it comes to participating in your legislative
processes.

So, I appreciate the chance to be with you.

First, I would like to inform you of the fact that at our testimony on
Wednesday before the Proxmire committee, Senator Proxmire agreed
to an invitation extended to him by Senator Marchi and myself that
his committee would be willing to come to Albany and hold a hearing,

...
I am going to try, in the brief time that I will take today, to just try and get a few very key points across.

Once again, with all of the strength that I can muster, I must state that it is totally impossible for the State of New York to solve a problem of this magnitude alone—absolutely impossible for this State to come to grips with the problem of helping New York City through this new crisis, with respect to the renewal of seasonal loans.

The State of New York does not have the wherewithal. The State of New York does not have the total ability to absorb all of the problems of this great city of New York, and I submit to you that it is, indeed, a problem which again warrants your further consideration and your help.

The most frustrating experience that we have had in appearing before other committees and in trying to establish a dialog on New York City, as State legislators, is the constant feeling that we get, that the New York City problem is, indeed, a local, provincial type of thing that might go away, or that, if anything, can be handled by the State of New York.

I submit to you, again, that the experience of 1975 and the problem we face is no different. The word “bankruptcy” is, indeed, a dirty word, and it is only to be used in cloistered quarters. But nevertheless, the potential bankruptcy of the City of New York or any type of fiscal problem, come June 30, 1978, is still going to have a substantial ripple effect on every municipality in this country and every city in this Nation, and I don’t think that fact should ever escape any congressional committee. And that is that as New York City goes, so goes a good portion of our Nation.

I am mindful of the very painful fact that our colleagues at the legislative branch of the City of New York have chosen at this time to vote themselves a salary increase. As one who has, in my 19 years in the legislature, been in a similar position, I can only say that fortunately or unfortunately I think the timing was bad. I think that the legislators of the City of New York who may or may not have a salary problem, indeed, chose a poor time.

But this should not, again, cloud the major issue that we are concerning ourselves with.

What are we going to do with the City of New York if she can’t get seasonal loans? What are we going to do with the credit of this great State? They are both, unfortunately, intertwined. If the City of New York has no help from the great Congress of this country, then the State of New York will topple immediately thereafter. And we kid no one, we will take the other 49 States with us as sure as we are sitting here, because we have learned from 1975’s experience that, aside from the fact that the tiny school districts on Long Island or the bigger municipalities in the western part of the State could not sell their bonds or they sold their notes at a premium, so, too, were other municipalities in this country very seriously affected. There was a great reluctance on the part of many investors to go into the lucrative municipal tax-free market, tax-exempt market, because of what was going on in New York City, and no one should forget that.

I want to say that with respect to the 1978 session of the legislature, there is no question in my mind that between Senator Marchi and myself and our colleagues, we will, indeed, explore other ways to find
some forms of help for the great City of New York, but this, in no way, can help us solve the ultimate problem of the seasonal financing for the City.

We will find a way as best we can to maintain aid levels in their present form. That may sound like it is insignificant, but there is constant pressure to drop aid programs which benefit the City of New York. There is constant pressure to abandon various types of aid programs which help other municipalities and help the City as well.

As far as we are concerned, we will try our best to see that the City suffers no further harm as a result of legislative action. But once again, we cannot do it without the help of the Congress in extending the seasonal loan program.

I think you are fortunate on your subcommittee in that you have the presence of former Assemblyman Bruce Caputo, who is now a Member of your body. He is fortunate to have escaped the legislature after most of the hard decisions were made, and he had to participate in those decisions, including saving the city of Yonkers from default, which is part of his congressional district. And he came to Congress well-versed in the many, what I believe are tremendous efforts that we made—tough decisions for two suburban legislators to vote for a lot of programs for the City of New York, to vote for extensions of money, to vote for State advances, to vote for various types of expansion of debt, to put the City of New York under a monitor, and ultimately, the city of Yonkers—as Congressman Caputo was asked to do, and to impose many strictures.

I might point out to you that the State of New York has learned many lessons from 1955. We have changed our approach to the way we govern. We have changed our approach with respect to borrowing. We go so far today as making our private colleges who want to borrow through the State of New York, using the vehicle of the dormitory authority, a State authority—we make those colleges take their endowment funds and pledge them as collateral before they can go into the bond market and go ahead and use the dormitory authority as the vehicle for lower interest obligations.

We have done a lot of things. We have got public authority control boards, on which Senator Marchi and I and the director of the budget sit. And I assure you that we are difficult people to come to for State money and for the good credit of the State of New York.

I don't want anyone to get the idea that the State of New York wants to get off scot-free, that we are asking for a handout from the Federal Government in asking for help for New York. We have made a lot of hard decisions, and I dare say in the months ahead we are going to have many more tough decisions to make.

We are going to put new strictures on a lot of our public agencies in this State, but there is no person or body in this State that can solve the problem of bailing out the city of New York without the help of the Federal Government. We are unable to go it alone. We have no solution for the seasonal loan extension problem. We have no magic formula that we can offer now or 90 days from now that will lift this problem from the shoulders of Congress.

So, we appreciate your coming to New York to listen to us, and we ask, of course, that you recognize and convey the message to your colleagues that this is not a problem that the State of New York can
solve; it is not something that, as Senator Proxmire has termed, is a problem where the State is not doing enough. Maybe we have not sold our case on how much we have done, but I submit to you that we have done far beyond what your wildest imagination could conjure up, and that it is impossible for us to go forward with any new magic programs for the City of New York without your help and cooperation.

I thank you for your patience, and I thank you for listening. [Mr. Kremer's prepared statement follows:]}

STATEMENT OF HON. ARTHUR J. KREMER, CHAIRMAN, WAYS AND MEANS COMMITTEE, NEW YORK STATE ASSEMBLY

There have been some published comments that the State of New York could and should do more to assist New York City if further federal assistance is to be obtained.

Seldom, however, is there mention of just what could and should be done or any recognition of the fiscal capability of the State to provide additional help. A clarification of the State's role in resolving the City's fiscal crisis may prove helpful.

Since the fiscal crisis broke early in 1975, New York State has provided substantial direct assistance to New York City.

The first action took place during the months of May and June, 1975, when the State advanced $300 million to the City. In order to provide the advance it was necessary for the State to, itself, borrow the money. The State has extended the advance annually since 1975.

Legislation establishing the Municipal Assistance Corporation (MAC) was enacted in June, 1975. Its purpose was to assist NYC in financing nearly $5 billion in outstanding short-term obligations. When MAC experienced difficulty in selling bonds, legislation was enacted establishing the NYC Emergency Financial Control Board. This legislation was necessary in effecting a complex financing package in which the State committed itself to purchasing $750 million of MAC and NYC obligations. Legislation had earlier been enacted mandating the State Comptroller, as trustee of the State's pension funds, to invest in MAC securities. That legislation was ruled unconstitutional by the State's highest court in September, 1975.

In order to appreciate these actions, it is necessary to understand the State's fiscal position during that period.

In February, 1975, the State's Urban Development Corporation with $1 billion of outstanding obligations defaulted on its short-term notes. Other State authorities were soon facing difficulty in marketing their obligations. Substantial direct State monetary assistance was required.

In addition, legislation was enacted establishing the Public Authorities Control Board to oversee public authority financing. Limits were placed on the activities of the troubled authorities and a complex financing package was developed to insure completion of essential projects.

At the same time, many other localities in New York were faced with severe financial problems. It was necessary for the State to advance $300 million to the cities of Yonkers and Buffalo. The State also purchased $15 million of Yonkers notes when Yonkers was unable to find a private purchaser.

These actions, as well as the enactment of emergency legislation for Yonkers similar to that of NYC, resulted in a resolution of the financial problems of those cities.

The State's budget for fiscal 1975-76 closed with a deficit of $450 million. The deficit was financed primarily through short-term borrowing. As a consequence of both State and City financial problems, the State was nearly shut out of private credit markets during the subsequent three months when it sought to obtain nearly $4 billion in fiscal 1976-77 seasonal borrowing requirements.

In spite of its borrowing difficulties and the fact that exorbitant interest costs (7.0%) were incurred, the State again advanced $800 million to New York City.

As the State was slow to recover from the 1974-75 recession, pressure mounted for a reduction in State governmental operations and programs to allow for tax reductions and an improvement in New York's economic climate. Even as the State worked toward this goal, it increased substantially its share of funding for the City University of New York (a $50 million increase), began a phased in
assumption of New York City court costs, and assumed 50% of the revenue shortfall to the City from the phased in full rebate of Stock Transfer Taxes. The rebate of the Stock Transfer Tax will ultimately cost the State $120 million per year, all of which will be distributed to NYC.

The need for a continued program of tax reduction by both the State and NYC cannot be overstated. The long-term hope for restoring economic and fiscal well-being to the State and City is conditional upon halting the erosion of their economic base. Just as the Stock Transfer Tax rebate program was essential to the preservation of New York as a financial center, similar actions will be necessary to halt the flight of other industry and business. Although additional financial burdens on the City and State will in the short-run result, longer-term improvements in the economy and tax base are expected. This will permit the provision of a more stable level of governmental services at a more reasonable cost to the people of New York.

New York State has in every way extended itself to assist NYC notwithstanding its own difficulties. However, NYC's greatest continuing needs cannot be met by the State. Now is the time for the federal government to recognize and accept its responsibility in providing for the poor and needy of the Nation. New York has always been committed to relieving the suffering resulting from poverty. However, the staggering costs of this commitment have placed New York at a considerable disadvantage in today's highly mobile national economy. It cannot continue. The federal assumption of NYC's welfare burden at an annual cost of $4.9 billion ($1.3 billion City share) may virtually eliminate its financial problems. The other major need of the City which requires federal help is borrowing assistance. The State's pension funds, the only large investment resource of the State government, cannot constitutionally be tapped to provide assistance to NYC.

It must also be pointed out that NYC's governmental operations are more extensive than those of the State. With this in mind, it is quite easy to see why the overwhelming magnitudes of NYC's financial problems are beyond available resources of the State. It is in the City's as well as the State's best interest that the State's fiscal stability not be jeopardized by unreasonable demands for assistance far beyond our capacity to provide.

Requesting continuing federal help in obtaining NYC's seasonal and capital borrowing requirements is not an enjoyable task. However, we believe that viable alternative solutions in New York are not readily available. We can handle neither the magnitudes of NYC's requirements nor a credit market characterized by uncertainty and near paralysis resulting from past associations with NYC's financial transactions.

I remind you that New York City's problem is not simply a local problem; nor is it exclusively a State problem. It is, in fact, a national problem. As you are well aware and failure by NYC to meet its borrowing requirements will have a deleterious effect on localities nationwide.

Restricted access to money markets will result in a myriad of problems for local governments throughout the country.

On Wednesday, I was similarly offered the privilege of appearing before the Senate Committee on Banking, Housing and Urban Affairs. As a result of the hearing I have agreed with Senator Proxmire and members of the committee to hold joint congressional-legislative hearings in New York on the financing plan soon to be submitted by the City of New York. I cordially invite your committee to join us in this attempt to obtain the maximum public input into the proposal that ultimately must be approved by both the United States Congress and the New York State Legislature.

Chairman Moorhead, Senator Marchi, I share entirely your view. I said in my opening statement that we recognize that the possible sins of its leaders should not be inflicted upon the people of New York City. But there is a psychological problem, and you, as a legislator, would understand that.

When Governor Carey was before us this morning, I talked to him about, not the seasonal loan, but the proposed long-term—legally long-term; hopefully it can actually be short-term or relatively short-term financing—if the State would in some way participate as a co-insurer or copurchaser of MAC bonds or something like that.
I came up with the figure of 50-50, at which point he blanched. But he did indicate—I don't mean I got a commitment from him—but in principle, for some percentage, he would agree with us. Do you think that would get support from the legislature if it was needed?

Mr. Marchi. I don't know whether he had his counsel with him at the time, but one problem—and certainly we would consider anything that is within the realm of the possible—is the constitutional prohibition against this. The constitution could be amended, but as those who have been former legislators know, it has to be approved by two successively elected legislatures and then submitted to the public. So, that before we have this in place, I don't see it as being immediately available. That is the big problem.

Certainly I don't think that any negotiation or any consideration should be carved in stone. We ought not to preclude any possibility—and certainly I am sure the fiscal committees would consider it. But aside from fiscal problems, there is a very strong constitutional problem which we could not overcome within the period of less than 3 years.

Chairman Moorhead. I understand that problem, if we take the loan guarantee route. But if we took the route of the purchase of MAC bonds, I don't believe your constitution——

Mr. Marchi. Yes; it would. This is the best legal advice that I have been able to get. I noticed that Mr. Goldin spoke to it, and presumably he may have gone into this, and he thought that there might be some possibility—I certainly would not want to preclude its consideration if, indeed, is available and feasible.

Chairman Moorhead. Well, I think what I am trying to say——

Mr. Marchi. Well, Yonkers—we were able to solve without this extraordinary intervention on the part of the Federal Government. Their problem was mainly the backlash of being too close to New York City.

Chairman Moorhead. Well, I hope you both understand what I am trying to say, that it will make it easier to sell it in Congress if we say the State is participating with us in this financing scheme.

I think you were here when Mr. Goldin testified, and he proposed that the State change the timing of State aid, which would reduce the City's seasonal loan problems. Is there any possibility of that being adopted by the legislature?

Mr. Kremer. Well, I think you have to understand, Congressman, that if we change the timing and we make our advances to New York City of State aid on an earlier basis, the State of New York has to pick that up during their fiscal year. The question of the timing is, it solves the problem of the City of New York, yet it doesn't alleviate our problem, which is that we must go to the market at a particular time which may not, in our opinion—I think, historically, it has not been the best time to go to market, consistent with what our fiscal year is.

We do our spring borrowing immediately after the State budget is adopted, by March 31, and then we start our spring borrowing. We can't change the State's fiscal year. I think that our borrowing, which might help the City of New York, would create chaos for all other municipalities in the State who borrow at different times throughout the year, because when you go with billions into the note market, short-term note market, it has an effect of depressing other people's interest and other types of municipal borrowing.
I think that Comptroller Goldin’s approach, which he brought to us earlier this year in bill form, is still worthy of consideration on some form of modified basis. But we could not start changing the complete advance to New York City and make it earlier and go into the market earlier without disrupting all of the municipal markets for the rest of the State.

Mr. Marchi. This is under consideration, Mr. Chairman. Both our fiscal committees are actively pursuing the question of better cash flow for localities, as well as the State itself. So, I think it is a legitimate question.

Chairman Moorehead. From your viewpoint, do you think that a mere extension of the seasonal loan program by the Federal Government is sufficient, or must there also be some sort of long-term Federal support?

Mr. Kremer. Obviously, the ultimate is the 25-year long-term support. That, I think, is the most realistic, for only one reason: Anyone who says to you that 3 years from now we are not going to come back in some way, shape, or form for some type of help — I still think that someone has to come back to the Federal Government 3 years from now, whether I will be in the legislature or not. But anyone who thought 3 years ago that we weren’t coming back was hallucinating, and we are going to be back for some type of help 3 years from now, so if we want to be realistic about once and for all putting the New York City problem in place, we have got to think about it in terms of a long-term solution as being the best solution, and not having New York City come back to Congress, along with all of us, every 3 years to plead for your assistance.

The answer is, obviously, the long-term solution is the best. The next most desirable solution is, of course, the Federal guarantee on the MAC bonds which we think has a significant impact.

Obviously, the least that we would hope to salvage from this is the renewal of the seasonal loans. Without that — of course, that would be disastrous if the seasonal loans were not extended.

From our standpoint, fiscally, the best thing is a long-term solution for New York City.

Obviously, there may be conditions attached to that, but that is something that everybody has to live up to. But as far as I am concerned, we would prefer the long-term solution because we think that is the most realistic approach.

Chairman Moorehead. Well, we like to see you, but we would like to adopt a solution where we would not have to see you every 3 years.

Mr. Kelly.

Mr. Kremer. Thank you, Mr. Chairman.

I noticed, Mr. Kremer, that you said that it is impossible for New York to do anything about this situation, and yet, in the areas where the action is, where $9 billion of the $13 billion of your budget exist, that you haven’t done anything about wages that are the highest in the United States of America.

Mr. Kremer. Congressman, can I respectfully interrupt you?

I am a State legislator.

Mr. Kelly. I understand that, but you are also a politician and understand the magic of political heat, and it has not been put on
these cats in New York City, because they haven't done anything about it, and there is no heat being put on them in the areas where they have to put it. That is just nonsense.

For you people in New York City—or not you, but the people in New York City to be paying absolutely the highest wages in the United States of America and then talking about poor people—that is not compassion for poor people. They are just buying elections with taxpayers' money and bankrupting the City, and now they want everybody to bail them out. And this is true in the area of welfare. It is true in the area of wages. And it is true in the area of rent control.

Now, they have not done anything about this, and that is where the action is. So, the idea that it is impossible, it seems to me, is just something to frighten the unwary.

And then, the other bugaboo about—"Look, we are going to go bankrupt. We will fall over dead if you don't save us." Now I don't know whether that is a safe threat or not.

Mr. Kremer. Take my word for it—it is, sir.

Mr. Kelly. Well, here is what the thing is, sir. If you think that 8 million people out of 215 million are so important that something bad happens to you, like throw yourselves on the floor and kick and scream, that the rest of us are going to go down the tube, you can forget it, because there is a lot of grit out there in the country. We are not in this mess because we have got the grit and we have got enough grit to survive your demise.

Now, the situation is clearly this: New York can help itself. It ought to get on with it and quit crying about the Federal Government coming to do it.

Now, you have not done anything in the areas where it needs to be done. It is all cosmetic, and this idea about—that you are going to go bankrupt—why would you go bankrupt? You don't need to, if you've got the political grit to face up to the unions. But as long as you let the unions control your government, they are going to run it into the ground, because this is the reason they exist. They have to have more membership, more dues, or pass off the scene. And, understanding that, you can't let them control the government. And since you have, you are bankrupt. And that is what it is all about.

Mr. Kremer. Well, Congressman, I always enjoy exchanging thoughts with another fellow-legislator on a much higher level, and I wish that the approach to New York City's problem could be just that simplistic. And many strangers who don't live in our State feel that way.

First of all, I want to point out to you that I don't know what motivated the Congress of the United States to bail out Lockheed, and that was not going to save the rest of the Nation. But somehow they found it within their wisdom to bail out the Lockheed Corp. And when someone says to me that the greatest city in this Nation—and you may argue that Orlando is the greatest city in this Nation—but I want to say to you that we are one of the greatest cities in this Nation, which has the brainpower and less of the Fortune 500 corporations than we have had before and is the true melting pot of this country and the heart of the financial center of this Nation, and I say that things like that, when they go under—and I kid you not, if the Congress chooses
to turn its back for whatever reason it chooses to on New York City on June 30—you are going to feel it in Orlando and you are going to feel it in Spokane, and don’t you kid yourself.

And then, there is going to be a question of what you are going to tell your constituents about how you turned your back on the City of New York because it was a “little local problem.”

Mr. Kelly. Well, Senator, let me say this to you. That may be the view of the politicians here, that that is so. But let me tell you something. I have enough confidence in the people of this City that that isn’t so, that when put to the task and the nonsense about that they can get something for nothing is over with, I think they will stand up and save their town, because all they have got to do is just make some sacrifices, modest sacrifices, the kinds of sacrifices that Americans all over this country have engaged in to save their country and the same kind that cause people to serve on volunteer fire departments for nothing. Some of them even pay to serve on them.

And so, this can happen in New York. I don’t think the people on the street are so cynical that they can’t try and save their town, and that somebody has got to do it for them. I just don’t subscribe to that. I don’t believe that about people in New York.

Mr. Kriemer. Congressman, all the City of New York is getting from the Federal Government is seasonal loans, and they are not getting them interest free. They are paying a good interest rate. No one is giving it away. It was apparently approved by Washington at the time because it was a recognition of the fact that this was, indeed, a national problem. And I submit to you that you can’t have a volunteer fire department for 8 million people, and you can’t have volunteers running the subways and policing the streets. You can’t have an auxiliary police department that protects 8 million people. It is too simplistic, Congressman, and it may fly somewhere else, but it won’t fly here.

Mr. Kelly. I agree with that, but you don’t have to be the highest paid people in the United States of America when you are bankrupt.

Mr. Kriemer. Well, in the private sector, we are, too, in New York City.

Mr. Kelly. Well, we don’t agree.

Chairman Moorhead. Mr. Caputo.

Mr. Caputo. It is good to see both of you gentlemen again, and I am glad you had time to come.

I just wanted to verify that you, like the mayor and the Governor and the comptroller of the City, before you, are not asking the Federal Government to give anything to the City of New York, not to provide any grants to the City of New York, nor to provide any other aid that all Americans are not entitled to.

Instead, your request is that the City have the privilege of paying 1 percent over the borrowing rate of the Federal Government for the purpose of those loans, and that you expect that that money will be repaid on time in full with interest at a profit to the Federal Government, as it has been to date. Is that right?

Mr. March. That is a good statement, and, as a matter of fact, it has been the track record during the life of the Seasonal Financing Act.

Mr. Caputo. So, the issue before this subcommittee, and, derivatively, before the Congress is, not how much the taxpayer will provide
the City of New York and its residents, but rather how much the City of New York, through the payment of interest on the borrowed cost to the Federal Government, will pay to the Federal taxpayer. Is that a fair statement of what you have asked for?

Mr. Marchi. That is a fair statement.

Mr. Gavrio. I would like to ask if either the Senate finance or the Assembly ways and means committee have studied this issue. It seems to me what the bankers told us today is that we have to have the courage to make the cuts necessary to balance the budget speedily. That at first blush sounds like a fiscal remedy. But reckless cuts which drive the middle class and business out of our City, fleeing the absence of fire protection, police protection, school services, and the rest, could create many more budget problems than it solves in the relatively short run.

Has anybody studied how far and how fast the City could go before it started creating more budget problems than it solved by budget cutting?

Mr. Marchi. Well, we both subscribe to the position that a program presented by the Governor, or variations of it, ought to contemplate an elimination of the expenditure side of the so-called capital budget, and the elimination of that factor completely so that we are much more attractive financially, returning under our own power.

And also, we have cost controls which have been instituted the last 2 years. The differences in costs have increased 4 percent over a period of 2½ years.

I still come back to the fact that $1 billion of the increase that brings us to $13.8 billion is welfare. And it is 35 percent of the City budget; and frankly, your colleague and our mayor-elect is going to have—

I am sure is going to exercise Herculean efforts within the tax levy portion of it, and that is the only portion of it that is available to him.

Certainly, to the extent that we can participate on a State level—and we are doing that; we are phasing in the assumptions of cost—we are going to do that. I am sure that the mayor-elect has this in mind, also. And we are asking for a little lessening help, and as you put it, the privilege of paying a little extra for the service, which we have indicated over the past 3 years, we are not a credit risk.

And also for greater presence in the cities, but not just the City of New York, the problems of the City, the President of the United States said it is the No. 1 problem in the United States—an economic problem.

Now, if that is No. 1 and we cannot touch that until 1981, I would hate to be No. 2 or 3 on his pecking order.

So, we need both. We are asking for this extension of credit as an indispensable bottom line. We also ask—that is not an exclusive plea; we are joining other hard-pressed urban areas around the country—to extend that same consideration. You don't have these meetings in many other areas of the country because many areas of the country are sharing these problems too. We are taking care of them here, and that is why they are coming here, and that is why we are here today, Mr. Chairman.

Mr. Kerr. Congressman, I would just point out that in 1975, as you know, we accepted many of the solutions offered us by the banks.
A certain amount of them were with blind faith because we did not have the ability to judge what the effect of those decisions would be. But we accepted them. I think they have a tendency, though, when it comes to the human side of the ledger, to treat these problems a little bit more cavalierly, perhaps maybe because many of the people who run a lot of the large institutions go to areas outside of New York City after 5 o'clock.

But the problem is that the solution to New York City's problems are our legislative level is not by massive cuts in social programs. We will, in the next 6 months, perhaps dedicate more of our staff and more of our people to scrutinizing the proposed City budget by the new mayor in an effort to see if we can help the City find areas where they can cut, but we are constantly asking, when cuts are made, to monitor, in terms of what is the loss in services to the constituency that still has to be served.

So, yes; our fiscal committees are, indeed, giving more scrutiny now than ever before to how New York City is going to spend its money, but we don't think that any kind of blanket statement that massive cuts have to be made and let the chips fall where they may—I don't think that solves the problem.

Mr. Marzulli. We are solving the problem of ineligibles that exists in New York and nowhere else in the State, and that is now beginning to conform to Federal standards, and that is an important saving, and that should not be inflicted on the people of the United States.

Mr. Caruso. My time is expired, gentlemen.

I would like to just get on the record a request that both of your staffs prepare a statement on whether the State could repeal title VI-A of the local finance law, and whether the State could withdraw the consent it has already given to the filing by local units of government, of petitions under chapter 9 of the Federal bankruptcy law. These have been mentioned frequently as things the State could do to help the problem, and I just wanted to repeat it.

Thank you, Mr. Chairman.

Chairman MOOREHEAD. Mr. Koch.

Mr. Koch. Mr. Chairman, thank you.

I just have a closing statement.

First, I think that these two men, Senator Marchi and Assemblyman Kremer, have stated our case in a way that cannot be improved upon. I know them both, and I was aware of their superb talents before. But I must say, not only am I increasingly impressed, but the fact is, that they and I and those others who appeared today have to get this case across to the American public. If your constituencies hear what they and the others that have come before you have said, then that which we are asking for will be viewed somewhat differently than the way it has been occasionally portrayed.

As Bruce Caputo has said on several occasions this morning and this afternoon, the City of New York is not seeking a handout or asking to be bailed out; it is seeking a loan. That is not so strange. Sitting, still, as a Member of Congress, I know how many countries we lend money to, and we don't put them through the agony that we are putting the City of New York through. It is incredible, when you think about it.
I have been on several committees. I have seen how generous and compassionate we are with people who are not our fellow citizens, and I am not for 1 minute suggesting that this committee is not compassionate and generous. You are—or you will be. [Laughter.]

But what I am suggesting is that we have to view the needs of the City of New York and the special problems that we have—some of them not of our own making and some of them of our own making. I have assured you and I assure you again, whatever it takes to remove the inequities, the incompetence, the corruption, the programs that we ought not to be providing, the people who are kept on the payroll who ought not to be there—that will be done.

But I ask you on the basis of our having made out a case and not on the basis of charity to view our request in a sympathetic way and to conclude that it is in the interests of the United States to assist its premier city—New York—which belongs to all of us.

Thank you.

Chairman Moorhead. Thank you, Mr. Koch, for that eloquent statement.

And I might take this opportunity to wish you well in your new endeavors and to say to the witnesses thank you for coming.

As we develop legislation, hopefully early next year, I hope that we can be in touch either in Albany or in Washington to see how we can structure a program that is not only sound but is salable to the U.S. Congress and to the people of the United States.

Thank you very much.

Mr. Caputo. Mr. Chairman, could I have unanimous consent to make a 1-minute statement to Mr. Koch on the occasion of what will probably be his last official public meeting as a Congressman, that we will miss him and we wish him well, and I was glad to serve with him.

Mr. Koch. Thank you very much.

Chairman Moorhead. That was within the 1-minute rule.

Thank you very much, gentlemen.

The subcommittee is adjourned, subject to meeting at the call of the Chair.

[The following letter with attached statement was received by the subcommittee from Martin Aaron, chairman of the Non-Institutional Committee for New York City Note and Bond Holders for inclusion in the record.]

Non-Institutional Committee for New York City Note and Bond Holders, New York, N.Y., December 5, 1977.

Hon. William Moorhead,

Dear Mr. Moorhead: Some time ago you were kind enough to reply to my letter addressed to Rep. Mario Biaggi on behalf of our organization which includes a number of his constituents. We were then engaged in fighting the moratorium on our New York City notes, the moratorium subsequently found unconstitutional by our State Appeals Court. Even though we were fortunate in obtaining the return of our defaulted principal, our concern with developments in New York City's tangle finances remains keen.

In that concern we note your reported hearing into N.Y.C. finances and budget to be held here in New York on December 13, 1977. A telephone call to your office elicited confirmation of the time from your staff person, Mr. Ruth Willick, but the exact location of hearing was not yet determined. I would like to offer
the attached statement for the record and am hopeful that we may be called
upon to express our thoughts, as individual investors, on the projection of con-
tinued short term financing by the Federal Government, despite the failure of the
city administration to take all possible steps to balance its budget and thus
convince private investors that the city is worthy of further investment in its
notes and bonds.

The correspondence between Pliny and the Emperor Trajan about the city of
Nicomedia almost 2000 years ago indicates that the problem of cities appealing
to the central government is not new. Trajan approved governor Pliny's request
for aid but instructed him to find out who was responsible for the previous waste
of money. Then Pliny reported about the city of Nicomedia which wished to help
build a new gymnasium. This time Trajan remarked that the gymnasium must be
completed with one which was within their means. How appropriate to these
Roman comments is the item in The New York Times of Dec. 1, 1977, this reports
"Convention Center pressed by Beaus-... the most recent estimates of building the
center put cost at $140 million to $170 million and assumed that $250 million would
draw on the center operating costs but in no case would meet the debt service on the
bonds which could be $20 million a year."

From a somewhat earlier era than Trajan came Hillel who was deeply con-
scious of social need and communal exigency. One of his far reaching enactments
was the PROBUSI, (a guarantee of payment) an institution without which
Jewish life would have been endangered. Because of then Biblical laws cancel-
ing debts in Sabbatical and Jubilee years (Deut. 25) creditors were becoming
increasingly hesitant about extending loans, and for good reason. I don't think
I ever saw well-fed rabbis in Mr. Blaustein's New York office and he could easily get confirmation of my allusion to Hillel.

Another great authority once said: "If we do not learn from history we are
bound to repeat it." I am much concerned that our city politicians old and newly
elected may not learn the bitter lessons and expect a messiah from Washington
to bail them out and forgive all their sins.

Sincerely yours,

MARTIN AMRON.

STATEMENT OF MARTIN AARON, CHAIRMAN OF THE NON-INSTITUTIONAL COMMITTEE
FOR NEW YORK CITY NOTE AND BONDHOLDERS ON PROBLEMS OF EXTENDING OR
TERMINATING THE FEDERAL SEASONAL FINANCING PROGRAM FOR NEW YORK CITY

Chairman Moorehead, and other honorable members of your committee: Your
chairman may recall correspondence with me, representing the problems of indi-
vidual investors in New York City notes and bonds which at that time were
in default but subsequently were repaid in full principal and interest of the
New York State Court of Appeals despite the long continued pleas of the Mayor
and other City officials that there were no funds to repay the defaulted notes.

Then the cry was set forth that the City would be forced into bankruptcy if
repayment was required. Finally through some strange manipulations the almost
one billion dollars was paid into the notes paid off. I was amused to hear Ed Koch, your former colleague in Congress and now our Mayor
elect, refer in a recent television interview to the finding of the funds as a
strange miracle which he would need much study to learn about such miracles.
I don't believe in miracles and do not think Mr. Koch does either. But both of us
know that the manipulations and double talk that goes on about New York City
budgeting is exceedingly strange, and that New York politicians have wondrous
ways their miracles to perform.

Forgive me if I presume to think that you, Mr. Chairman and the majority of
Congressmen, approach these manipulations and claimed miracles with more
than a grain of salt. I have only just come through the bitter experience of
fighting for repayment of my savings which I trustingly invested in the city of my
birth only to find that I and the thousands of similar individual investors were
deliberately selected as sacrificial goats by our New York State Legislature which
disregarding the clear mandates of our state constitution enacted a bill to de-
clare a moratorium on New York City notes alone while continuing to provide
for paying on longer term bonds, although both notes and bonds were issued
under the full faith and credit clauses of our state constitution governing
municipal securities. Thank God that our State Court of Appeals refused to accept this cap out and said the moratorium act was unconstitutional and that it had to be repaid forthwith.

As I said, despite the pitiful cries of the Mayor, he found by aforesaid miracle, which I term manipulation just as he had manipulated for many years in city budget accounting, the billion dollars to pay up. Of course, at this time he was running for re-election and such times seem to spur his kind of miracle. But you can’t fool all of the New Yorkers all of the time and Mayor Beame was turned away by the same sort of individuals as I am and represent. We wish Mayor elect Koch good luck and appreciate his candor in acknowledging that he does not expect to create the same kind of miracle government as his predecessor. I am afraid that Mr. Koch will find that Mayor Beame left behind time bombs with slow fuses to explode next year perhaps even before Mr. Koch learns where the miracle manipulation money is hidden and where still undisclosed debts exist to explode the so-called balanced budget, the gap in which is projected from anywhere from $400 million to twice that amount.

You will find in my testimony before the Senate Banking, Housing and Urban Affairs Committee last April that Mayor Beame was projecting receipt of $400 million from the Federal Treasury in addition to the vast sums already being given to the City under various grants in aid and community assistance appropriation programs. Beame planned that HUD would buy outstanding city mortgages on housing projects. I pointed out then and repeat today that the figures so projected were false in that the tenants in these Mitchell Lama houses refused to hear even the existing rents that are insufficient to amortize the mortgages. I am sure that your committee and that of Senator Proxmire will demand proof from HUD that any mortgages taken over are a sound investment or can be made so readily. We all know that recently the bond and mortgage rating service Moody’s expressed the truth about the credibility of the City’s effort to float a new note issue. That issue was withdrawn but I note that the securities disclosure statements made to potential underwriters have not been made public despite the City having spent about a half billion dollars to prepare them. Obviously your committee should review these statements carefully to see what hazards you face in evaluating the risks in extending the present Federal Seasonal Financing Act beyond next June 30th. We note that the Municipal Securities Full Disclosure Act of 1977 sponsored by Senators Harrison Williams, William Proxmire and Jacob K. Javits is still awaiting action by Congress. We know that that the recent SOO staff report excoriated City officials and banks on concealment of facts while lending large amounts of notes in 1974 and 1975.

I note that in my letter of April 17, 1976 addressed to Representative Biggi which was part of the correspondence with Chairman Moorehead since Mr. Biggi forwarded it to him, there is reference to Representative Herman Badillo who at that time was quoted in the press as recommending full default bankruptcy for the City. We all recall that Congress passed legislation to provide for just such a contingency. Now we read that Mr. Badillo is to become Deputy Mayor under Mr. Koch. In my letter I also made mention of statements by Comptroller Goldin and Felix Rohatyn that: “among the investors who would be affected by the bankruptcy would be the City’s pension systems and their retirees...” Mr. Rohatyn also said: “There are all these letters of complaint from gray-haired small investors who have everything they own in the city.” Of course Mayor elect Koch has declared that bankruptcy will not be the course he will pursue but perhaps Mr. Badillo can bring things to bear on Mr. Koch whom no one can easy facing union wage negotiations very soon while the New York City Council hastily proposes to increase its own salaries substantially as well as increasing the salaries of other City officials.

Recalling that there is another side to union wage negotiations comprising fringe benefits and pensions, I note that in my letter to Representative Biggi, I suggested the possibility of Federal insurance of pensions similar to the insurance of The Pension Benefit Guaranty Corporation set up pursuant to the Employee Retirement Income Security Act of 1974 (Public Law 93-406) (ERISA). Under date May 10, 1976 the Congressional Research Service reported to Mr. Biggi that there was before the House Education and Labor Committee a proposal, H.R. 1145, Public Employee Retirement Security Income Act of 1975 which would permit the Pension Guaranty Corporation to insure employee pension benefit plans of State and local governments. The Congressional Research analyst in his letter just mentioned states that under ERISA pension plan fiduciaries
are to diversify plan assets to minimize the risk of large losses. "Generally," the
analyst states: "No more than 10 percent of plan asset may be in securities
or real property of the employer. . . . This would pose a problem for municipal
government such as NYC where the public pension plans have purchased large
amounts of Municipal Assistance Corporation bonds. Hearings were held on this
subject in regard to the NYC pension fund on February 25, 1976 before the House
Ways and Means committee." The analyst also refers to Internal Revenue Code
requirements, see Section 503(b) of the IRS code. These govern the municipal as
well as private pension plans. They lost their tax exempt status if it leads to a
substantial contributor without adequate security and at reasonable rate of
interest.

We recall the shenanigans that went on in 1975 and 1976 when the so-called
independent trustees initially raised the question of fiduciary responsibility under the famous 'prudent man dictum' concerning fiduciary trustees and
then quickly acquiesced to their union bosses and agreed to take very large
amounts of City and MAC securities even though this entailed in some cases the
sale of other pension assets at substantial losses in order to provide the money
for the purchase of them and still doubtful city and MAC securities. But recog-
nizing the faults in the City pension systems and their inability to withstand
union leaders demands in face of public knowledge that those leaders employ
their dominance over the trustees to wield their power over the pension invest-
ments as a weapon in union negotiations on wages with the city. You know that
there hangs over the upcoming wage negotiations between Mayor Koch the fact
that the pension systems have $800 million in city notes due this spring and are
being expected to invest much more city securities if even the weak city budget
plans are to be made viable.

We recall that recently the Friedan's pension system was deemed to be some
hundreds of millions under actuarial projections of solvency over the near
long term. We recall too the reports of the Shain commission on the pensions and
its recommendations. All these factors should be taken into account in your
committee analysis of the City's needs for further Federal Financing. Perhaps
your making such financing contingent on a realistic long range plan for con-
tinued budget balancing and circumscribing the propensities that the New York
State Legislature as well as the city has shown in bestowing pension benefits
without regard to solvency will finally lead to a realistic solution of these vast
debts overcharging the City if the pensions promised retiring employees are to be
met. It has been the practice in this area as well as in the other budget figures to
push off to some unknown future the debts incurred today with regard to the pen-
sion obligations. You already have realized how cavalierly the City threw expense
items into its capital budget. Thus there is need for capital replacement needs of
the City are neglected. Further the Mayor has boasted of his plans to reduce
real estate taxes. The simple truth is that the NY State Constitution mandates
that there shall be unlimited increases in real estate and other taxes to meet debt
requirements. Perhaps Mayor Koch is not as indebted to the real estate interests
who were the backers of Mayor Beame in his election campaigns. We all agree
that taxes should be reduced whenever possible but not in the face of danger to
outstanding obligations whether in securities or contract obligations.

We note the statements of Secretary of the Treasury W. Michael Blumenthal
and his Deputy Roger Altman as reported in the New York Times on Dec. 1,
1977. Speaking before the New York Board of Trade he declared: "The plain
fact is that an operating budget isn't balanced unless total revenues meet total
operating expenses are equal." He warned New York City that it could expect
no further Federal loans unless it was prepared to bring its budget into balance
and, within three years, stop including operating expenses in its capital budget.
He further noted: "That the change in the City's budgeting policy would add $130
million a year to the City's expense budget over the three-year period. In addi-
tion to requiring change in the City's accounting practices before sponsoring fur-
ther loans, the Carter Administration would take a close look at the extent of
the state's contribution to the City's needs.

The basic premise of the current Federal Seasonal Financing Act is that the
City cannot collect such income as state aid, such as educational assistance per
school child, in timely fashion since the City's fiscal year does not coincide with
the state tax cycle. Therefore the premise of the Federal Seasonal Financing
was to advance short-term funds to City pending collection of state and other
income. There is no reason other than political expediency to prevent the state
from advancing its assistance in timely fashion. It may be that the state might have to issue short-term securities, but it is manifest that the state now can do so at much lower rates of interest than is currently required for the Federal advances. Obviously the fact that state securities are free of all income taxes, Federal, State and City makes such tax exempt instruments salable at much lower rates than the treasury itself can obtain. However, our Governor employs a very arthritic financial consultant in Felix Rohatyn. I note his recent proposal that the U.S. Treasury lend $225 billion to M. A. C. under 25-year term bonds subordinated to existing MAC bonds. Under this scheme the state would be relieved of $600 million which it advanced to NYC by reimbursement from the Federal money given for the MAC bonds. Of course we recall that MAC counsel Simon Rifkind was the author of the infamous note moratorium bill that the NY State Legislature passed on his demand that it was the only way to meet the NYC fiscal crisis. A number of members of the NY legislature complained that the bill was unconstitutional but they passed it anyway on Judge Rifkind's stress on his opinion that it was entirely constitutional. We say infamous because it selected what they thought to be a defenseless group of unorganized individuals who invested in the notes as sacrificial sheep. What gall its MAC authors must have if they now call upon Congress to become similar sheep.

We recall that the NY State Legislature recently passed legislation upon the demand of the City and Governor Carey under which the state aid to NYC school pupils which is based upon per capita school attendance would be diverted to back up MAC notes to be issued to investors. I already have mentioned that this scheme is founded upon Moody's calling the issue a poor risk. We have a deep philosophical aversion to this shifty scheme. It might well have been deemed unconstitutional by the same Court of Appeals that overturned the equally unsanctioned prior moratorium scheme. This new bill could undeniably deprive NYC school children of the per capita aid that would continue to flow to school pupils in New York State outside the city. We cannot conceive that the State Court will uphold such an invidious distinction between those pupils who happen to live outside the city and those within the city. Perhaps it is well that Moody's upset the scheme to begin with. We should note that only when they did so were the banks and underwriters ready to refuse to underwrite the issue. These gentile certainly were not about to consider the danger to NYC school pupils in the way in which they demanded that the notes be backed by diversions of school aid in the same way that the sales tax and other state taxes are diverted from the City's coffers to back up MAC bonds. We all resent the manner in which Robinson and MAC made the interest rates unconscionably high in their issues addressed to the bankers while trying to induce the note holders to convert to 10-year and 15-year term bonds at lower rates. The market quotations show that MAC bonds at the higher rates of interest are quoted about 10 to 15 percent above par while the lower rated bonds are quoted below par. He holds out the extremely delicate proposition that in several years the market for City securities would prove so viable that the Treasury could sell in the marketplace the bonds that it would have acquired. This is a real Felix the Firerer dream boat. It happens to coincide with the unraveling of his previous scheme whereby ITP acquired Hartford Fire Insurance. You all will recall Mr. Rohatyn's unsavory reputation in that deal which was exposed during the Watergate revelations. Why Governor Carey persists in using him as financial guide and mentor is beyond our comprehension. But we expect to have opportunity to let the Governor know our feelings this fall if he runs again for his post. Our feelings bear most heavily in the ballot box and there too we can show the legislators what we think of their sorry performances.

The magnitude of the City's financial problems might best be brought out by this recent news. At the same time it shows the magnitude of Federal aid in the problem. The Times reported recently on its front page that the Board of Education spends $1,000 per daily lunch for pupils in the City schools. Of this the Department of Agriculture reimburses 81 cents while the City puts up 35 cents. But there are 500,000 such lunches provided daily. That means $125 thousand dollars a school day and there are 185 school days a year. So we realize that over $23 million dollars a year goes to this one thing out of City funds. Not that one can object to the purpose as compared with shuffling political fat cats with high salaries and encomiums. But the sad fact the newspaper brought out was that most of the lunches go into the garbage because the kids won't eat the meal provided. Now the story states the schools are going to adopt the same type
meals as McDonald's and the other fast food stores provide and the kids obviously must enjoy. I wonder if the NYC schools are going to still spend $1.06 per lunch in face of the fact that McDonald's serves a hamburger and a drink for 70 cents, while paying overhead, taxes etc. It might be noted that Victor Gruen was quoted as saying that there was more to the matter than meets the eye. Certainly since his union represents the lunchroom workers and you may be sure that a very large proportion of the lunch costs is represented by labor and not food itself. You can be sure that no item for overhead or taxes is included in the City accounting for such costs, despite the fact that there is a very large central commissary and kitchens maintained by the Board of Education with a commensurately large bureaucracy. Where such costs are buried in the maze of education board budgets might defy even expert accountants.

Now we don't want to leave you and the committee with only negative comments. Two and a half years ago I published an article in the hands of the City unions and to Mr. Dolatyn suggesting that employees of the City might well be able and amenable to purchase of City securities in order to avail themselves of the complete tax free status such investments provide. Since teachers, police, firemen, sanitation men all average salaries above $15,000 a year and in many cases have wives who work also, the federal income tax alone can run 20%, 25% or 30% percent of gross wages. I then pointed out that forcing the pension systems to buy the city securities as these systems already have tax exempt status, created all the danger of investment risk while not enjoying the great advantage of tax free income that induces so many individuals to invest in municipal securities. In addressing my suggestions to Mr. Delany of the Sanitation union, whose consultant is known to be Jack Nieg, I hoped that that expert advise the unions on the merits of my proposal. Similarly to Albert Shanker whose union advertises its pension expertise. Herewith is the published suggestions issued in local New York newspaper in June 1973 when Victor Gruen started a pressure campaign against the Bill, leading mass picketing to the banks Wall Street offices. As we all know, Walter Wiston of the bank and Mr. Gruen are buddy-buddy, each trying to escape the onus of responsibility for the City's lack of ability to enter the investment market to sell its notes or bonds. The bank chairman knowing that under the fraud class action pending in Federal Court his bank and all the New York Banks who knowingly concealed the near insolvency of the city in 1974 and 1975 might suffer tremendous losses. The union leader still trying to forestall an equally adverse result in the court of public opinion.

Now we return to our original suggestions, supplemented by the more recent developments, the consciousness of the City employees that their pensions may well be endangered either by bankruptcy or the sheer necessity to radically revise the pension contributions of the City. Obviously in bankruptcy the contractual arrangements of the pension systems will be subordinated to repayment of the outstanding City debt pursuant to the full faith and credit provisions of the State constitution. Therefore I suggest that part of the salaries of the higher paid City employees be met in City debt notes or similar instruments, to be tax free upon receipt and as long as held to maturity. This is similar to treasury B bond practice now. Moreover, to induce employees to accept such a scheme, I suggest that these securities be insured by the Pension Guaranty Corp. as previously mentioned under the ERISA act to be amended to include municipal and State pension holders. Of course I do not suggest that thereby the City be relieved of its proper burden of paying its correct burden of pension contributions as well as providing for the repayment of its securities in due and timely fashion together with the rate of interest specified or to be specified on the face of the securities issued. Rather that Federal supervision of the City budget be continued as long as the pension systems are found to be not in true actuarial balance and such supervision to mandate inclusion in each City budget of sufficient sums to meet actuarial requirements and that notes issued to employees as above suggested also are amortized in timely fashion by sums included in City expense budget sufficient to meet such notes or bonds under the full faith and credit provisions of the State constitution. Fulfilling such budgeting all Federal assistance to the City shall be withheld to make good the guarantees as we here mentioned and strongly support.

[Whereupon, at 5 p.m., the subcommittee was adjourned, subject to the call of the Chair.]
NEW YORK CITY FINANCING ACT OF 1975
P.L. 94-143

NEW YORK CITY SEASONAL FINANCING ACT OF 1975
P.L. 94-143, see page 89 Stat. 797

House Report (Banking, Currency and Housing Committee)
No. 94-632, Nov. 6, 1975 [To accompany H.R. 10481]

House Report (Ways and Means Committee) No. 94-632 (Part II),
Nov. 13, 1975 [To accompany H.R. 10481]


DATES OF CONSIDERATION AND PASSAGE
House December 2, 1975
Senate December 5, 1975
No Senate Report was submitted with this legislation.

HOUSE REPORT NO. 632—Part I

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 tax-
ation; 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.

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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 de-
fault? 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 prob-
lems have accrued to the State as a consequence of this in-
volve? 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
program?