APPROVED

DEC 9 - 1975

Posted 12/9

To archives 12/10

ACTION

Last Day: December 19

THE WHITE HOUSE

WASHINGTON

December 8, 1975

MEMORANDUM FOR THE PRESIDENT

FROM: JIM CANNON

SUBJECT: Enrolled Bill H.R. 10481 - New York City Seasonal Financing Act of 1975

Attached for your consideration is H.R. 10481, sponsored by Representative Stanton, which authorizes Federal loans up to $2.3 billion to New York City to meet seasonal financing needs.

Additional information is provided in OMB's enrolled bill report at Tab A.

OMB, Max Friedersdorf, Counsel's Office (Lazarus), Bill Seidman and I recommend approval of the enrolled bill.

RECOMMENDATION

That you sign H.R. 10481 at Tab B.

EXECUTIVE OFFICE OF THE PRESIDENT

OFFICE OF MANAGEMENT AND BUDGET

WASHINGTON, D.C. 20503

DEC 8 1975

MEMORANDUM FOR THE PRESIDENT

Subject: Enrolled Bill H.R. 10481 - New York City Seasonal Financing Act of 1975
Sponsor - Rep. Stanton (D) Ohio

Last Day for Action

As soon as possible

Purpose

To authorize Federal loans to New York City to meet seasonal financing needs.

Agency Recommendations

Office of Management and Budget	Approval
Department of the Treasury	Approval (Informally)
Department of Justice	Approval (Informally)

Discussion

With the exception of technical clarifying amendments and a provision relating to the General Accounting Office (GAO), H.R. 10481 is substantially identical to the Administration's bill. That provision would permit GAO to audit all books, accounts, records, and transactions of New York State or City as the Secretary of the Treasury or the Comptroller General may deem appropriate.

The Secretary of the Treasury is authorized by the bill to make loans to New York City, or to any agency authorized by the State to act for the City, for seasonal financing needs.

The total amount of such loans outstanding at any time is limited to $2.3 billion. These loans will bear an interest rate one percent higher than the market rate on U.S. obligations of comparable maturity. Each loan must mature no later than the end of the City's fiscal year (June 30) in which the loan is made. Loans may be made only if the Secretary determines that there is a reasonable prospect of repayment, but no loan may be provided unless all matured loans have been repaid. The Secretary may require security for the loans. Moreover, in order to offset Federal claims against New York in connection with delinquent repayment of loans made under this Act, appropriation acts may provide for the withholding of Federal payments to the City directly or through the State.

The bill establishes a revolving New York City Seasonal Financing Fund, to be administered by the Secretary of the Treasury, and authorizes the appropriation of $2.3 billion to the Fund for the purpose of making loans. All repayments of principal are to be returned to the Fund, but all income from Fund investments and loans reverts to the Treasury as miscellaneous receipts. Upon termination of the Fund's authority on June 30, 1978, the balance is returned to the Treasury. The Secretary is authorized to sell any note or loan obligation held by the Fund to the Federal Financing Bank. Such sale would have the effect of taking the loans "off budget."

Finally, an appropriation authorization of such sums as may be necessary is provided for administrative expenses under this Act.

James M. Frey
Assistant Director
for Legislative Reference

Enclosures

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET

DATE: 12-8-75

TO: Bob Linder

FROM: Jim Frey

Attached is the Treasury views letter on H.R. 10481, which was delivered today. Please have it included in the enrolled bill file. Thanks.

OMB FORM 38
REV AUG 73

THE GENERAL COUNSEL OF THE TREASURY

WASHINGTON, D.C. 20220

DEC 8 1975

Director, Office of Management and Budget
Executive Office of the President
Washington, D. C. 20503

Attention: Assistant Director for Legislative Reference

Sir:

Reference is made to your request for the views of this Department on the enrolled enactment of H.R. 10481, the "New York City Seasonal Financing Act of 1975."

The enrolled enactment incorporates the Administration's proposal to provide loans to New York City not to exceed in the aggregate $2,300,000,000. The Department recommends that the enrolled enactment be approved by the President.

Sincerely yours,

Richard R. Albrecht
General Counsel

ASSISTANT ATTORNEY GENERAL
LEGISLATIVE AFFAIRS

Department of Justice
Washington, D.C. 20530

December 9, 1975

Honorable James T. Lynn
Director, Office of Management
and Budget
Washington, D.C. 20503

Dear Mr. Lynn:

This is in response to your request for the views of this Department on H.R. 10481, a bill "To authorize the Secretary of the Treasury to provide seasonal financing for the City of New York", as it appears in the December 2, 1975 daily edition of the Congressional Record. The legislation sets forth procedures for the Secretary of the Treasury to loan up to $2.3 billion to the City of New York.

The Department of Justice has no objection to Executive approval of H.R. 10481.

Sincerely,

Michael M. Uhlmann

Michael M. Uhlmann

AMERICAN REVOLUTION BICENTENNIAL 1776-1976

ACTION MEMORANDUM WASHINGTON LOG NO.:

Date: December 8

Time: 1230pm

FOR ACTION: Bill Seidman
Art Quern
Max Friedersdorf
Ken Lazarus

cc (for information): Jack Marsh
Jim Cavanaugh

FROM THE STAFF SECRETARY

DUE: Date: December 8 Time: 300pm

SUBJECT:

H.R. 10481 - New York City Seasonal Financing Act

ACTION REQUESTED:

____ For Necessary Action

____ For Your Recommendations

____ Prepare Agenda and Brief

____ Draft Reply

x____ For Your Comments

____ Draft Remarks

REMARKS:

Please return to Judy Johnston, Ground Floor West Wing

No objection
per EC Schmults

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

For the President

THE WHITE HOUSE

WASHINGTON

December 8, 1975

MEMORANDUM FOR: JIM CAVANAUGH

FROM: MAX L. FRIEDERSDORF M. L.

SUBJECT: H.R. 10481 - New York City Seasonal Financing Act

The Office of Legislative Affairs concurs with the agencies that the subject bill be signed.

Attachments

ACTION MEMORANDUM WASHINGTON LOG NO.:

Date: December 8 Time: 1230pm

FOR ACTION: Bill Seidman
Art Quern
Max Friedersdorf
Ken Lazarus

cc (for information): Jack Marsh
Jim Cavanaugh

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ACTION REQUESTED:

___ For Necessary Action ___ For Your Recommendations

___ Prepare Agenda and Brief ___ Draft Reply

x ___ For Your Comments ___ Draft Remarks

REMARKS:

Please return to Judy Johnston, Ground Floor West Wing

EPB
approval
JWS

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

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for the President

THE WHITE HOUSE

ACTION MEMORANDUM — WASHINGTON — LOG NO.:

Date: December 8 — Time: 1230pm

FOR ACTION: Bill Seidman ok
Art Quern ok
Max Friedersdorf ok
Ken Lazarus

cc (for information): Jack Marsh
Jim Cavanaugh

FROM THE STAFF SECRETARY

DUE: Date: December 8 — Time: 300pm

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ACTION REQUESTED:

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___ Prepare Agenda and Brief ___ Draft Reply

x For Your Comments ___ Draft Remarks

REMARKS:

Please return to Judy Johnston, Ground Floor West Wing

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

K. R. COLE, JR.
For the President

To -
J. Cavanaugh
12-8-75
12:10 p.m.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

DEC 8 1975

MEMORANDUM FOR THE PRESIDENT

Subject: Enrolled Bill H.R. 10481 - New York City Seasonal Financing Act of 1975
Sponsor - Rep. Stanton (D) Ohio

Last Day for Action

As soon as possible

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The Secretary of the Treasury is authorized by the bill to make loans to New York City, or to any agency authorized by the State to act for the City, for seasonal financing needs.

INTERGOVERNMENTAL EMERGENCY ASSISTANCE ACT

NOVEMBER 6, 1975.—Ordered to be printed

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

REPORT

together with

ADDITIONAL, INDIVIDUAL, SUPPLEMENTAL, MINORITY, AND DISSENTING VIEWS

[To accompany H.R. 10481]

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

The amendments are as follows:

Page 3, line 7, strike out "102d" and insert "101(d)".

Page 4, line 17, strike out the semicolon and insert the following:

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

HEARINGS

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

1. What is the current financial situation in New York City and how did this develop? What would be the consequences of default? What is needed to prevent default?

57–006

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

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

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

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

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

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

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

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

Need for the Legislation

1. Effects of Default on New York City

Your Committee believes that in the absence of Federal guarantee assistance as provided in this legislation, your Committee believes that New York City will be forced to a default on the great majority of its $2.5 billion in short-term obligations maturing between December 1, 1975 and June 30, 1976, and that the effects of such a default would be lasting and destructive. In the immediate aftermath of a default, the city would face a shortfall of about $1.2 billion in the cash

which it requires for operating expenses and capital projects from December through March. Without Federal assistance, the city will probably find it impossible to market the tax anticipation notes which ordinarily meet that shortfall. Were that $1.2 billion not to be forthcoming from any source, cuts amounting to about one-third of total city expenses exclusive of debt service would be required; these cuts would represent most of that part of the expense budget within the control of the Mayor. Mayor Beame has testified that such an event would leave the city virtually without police, firemen, sanitation, or schools. Vendors who supply the city's hospitals, schools, administration and essential services would not be paid; general shortages and a wave of personal bankruptcies might ensue. Your Committee believes that this could not be allowed, and therefore concludes that Federal guarantee assistance would be forthcoming through renewed legislative action in any event.

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

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

2. Effects on the Municipal Bond Market

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

> The impact of a New York City default on the municipal bond market is much more hazardous to predict [than the impact on individuals and insurance companies]. To date, the evidence indicates that New York's problems have had

little, if any, impact on the situation facing most municipal borrowers. Yields on municipal issues have maintained their historic relationships to those on corporate issues of comparable maturity and quality. While municipal rates have edged up recently, so too have the rates for corporate and federal securities. Of course, it is possible that when more recent data are processed, they will show that a dramatic shift has taken place.

There are some significant exceptions to these generalizations. Investors have clearly started to shy away from low quality municipal offerings. However, the extent to which this is the by-product of New York's difficulties rather than the competition from an unusually large quantity of high quality municipal and treasury offerings cannot be determined with precision. Some larger, older cities, especially those in the eastern and northcentral areas, have been forced to pay unusually high rates of interest, probably because of their superficial fiscal resemblance to New York. For example, the rate paid by Philadelphia rose from 6.5 percent in February to 8.5 percent in July. Detroit, partly because of its extremely high unemployment rate and its budgetary problems, has been forced to pay roughly 9 percent throughout 1975. The specter of a city default dragging down the state has forced New York State's rate up to 8.7 percent. It also should be noted that certain borrowing agencies such as the Housing Financing Agency in New York and its sister organization in Massachusetts, both of which relied on rolling over short-term notes to avoid the high rates associated with long-term borrowing, have been forced out of the market completely because no syndicate will underwrite their bonds.

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

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

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

3. Effects on the Banking System

Your Committee received much testimony on the effect of a New York City default on the banking system, much of it in disagreement. The testimony on behalf of the Board of Governors of the Federal Reserve System was that "the public need not fear for the stability of our banking system if a default does in fact take place." The Comptroller of the Currency testified that the effects would be "controllable", and the Chairman of the F.D.I.C. reported that, under certain assumptions, fewer than 30 of 8,889 nonmember insured banks surveyed would become causes for supervisory concern in the event of default. On the other hand, the Superintendent of Banks of New York State testified that a New York City default would have "severely adverse" consequences for the banking system. The Chairman of the Board of the Morgan Guaranty Trust Company of New York testified that, in his opinion, "the potential consequences of any default are essentially unknowable before the event".

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

A second significant danger to the banking system might arise if New York State and its agencies were forced to default in the wake of New York City. While testimony from regulators was in agreement that the number of banks placed in jeopardy by virtue of their excessive holdings of New York City paper is relatively small, most testified that the further default of the State would make matters considerably worse. Whether such a further default might trigger psychological reactions leading to collapse can only be guessed.

If one assumes that neither of the aforementioned disasters were to occur, then the effects of a New York City default on banks and other financial institutions which hold maturing New York paper may be summarized as follows:

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

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

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

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

4. Effects Throughout the Economy

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

5. The Effects on America's International Position

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

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

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

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

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

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

Switzerland

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

Paris, France

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

London, England

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

Tokyo, Japan

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

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

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

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

Leaders in foreign countries do not, as do many Americans, confuse the bankruptcy of a corporation in the private sector (such, for example, as Lockheed) with the default by a major arm of Government. The default of a private company is, as they see it, a phenomenon quite

normal in the operation of a capitalist system; but for the Federal Government to sit by immobilized while one of the great cities of the world defaults on its obligations would, however unfairly, raise questions as to the good faith of our political authorities and create doubts as to the responsibility of our national Government and, hence, the validity of its promises.

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

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

Purpose of the Bill

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

The total amount of long-term obligations which could be under guarantee at any one time could not exceed $5 billion; this would drop to $3 billion in 1989, and all guaranteed obligations would have to have a final maturity in fiscal 1999 or earlier. In addition to the foregoing, outstanding guaranteed short-term (11-month or under) obligations could not exceed $2 billion at any one time.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Federal assistance to New York City can also be justified on traditional grounds of the commerce power. Whatever the estimate of the consequences of a default by New York City on the economy of the Nation, there is little question but that such a default would greatly affect interstate commerce in municipal securities and could lead to a general loss of confidence in other securities as well. A New York City default would have far-reaching impact and effect on interstate commerce, and the prevention of such adverse impacts on interstate commerce is clearly within the established ambit of the commerce clause. It is hard to argue that the prevention of the adverse impact of default on interstate commerce is less justifiable an exercise of congressional power than the regulation of the adverse impact flowing from environmental damage, or the regulation of adverse effects of the payment of inadequate wages to workers employed in industry or in State and local government.

Detailed Description of H.R. 10481

Structure of the Bill

Title I of the bill sets forth the circumstances under which Federal aid may be made available to a distressed municipality in the form of a guarantee of State obligations which are issued for its benefit. Title II of the bill makes a conforming amendment to the Internal Revenue Code to provide that the interest on any obligations so guaranteed shall be subject to Federal income taxation. As reported by this Committee, the bill contains a heading for a Title III setting forth an amendment to the Bankruptcy Act in the event that a bill containing such provisions might possibly be reported by the Committee on the Judiciary and incorporated into H.R. 10481 by a later amendment. In the material which follows, under headings which correspond to the Title and section headings of the bill as reported, the legal effect and intended purpose of the provisions of Title I and II are discussed in detail.

Section-by-Section Analysis

§ *1. Short Title*

This section provides that the short title of the Act is to be the Intergovernment Emergency Assistance Act.

TITLE I—INTERGOVERNMENTAL EMERGENCY ASSISTANCE

§ *101. Definitions and rules of construction*

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

§ *102. Establishment of the Board*

This section sets up the Intergovernmental Emergency Assistance Board, which is vested with the discretion to issue guarantees under this Title. The Board, whose decisions are to be made by majority vote, is composed of the Secretary of the Treasury, 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.

§ *103. Authority for guarantees*

This section authorizes full or partial guarantees of State obligations, and requires that where the Board denies an application, it must report its reasons in writing to the Governor of the State concerned and to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Banking, Currency and Housing of the House of Representatives.

Section 103 refers to the rule of construction set forth in section 101(d) in order to make clear the intention that obligations of a State agency or instrumentality may be guaranteed by the Board if the purpose of the State law creating it was to provide a mechanism to deal with the fiscal problems of a municipality.

§ *104. Purpose.*

Guarantees may be made for either of two purposes. One is to enable the municipality to continue to provide essential public services and facilities. The other is to prevent or mitigate the effects of a default which has had, or which can reasonably be expected to have, a serious adverse effect on general economic conditions or on the marketability of tax-exempt securities in general.

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

§ *105. Conditions of eligibility.*

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

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

In the same vein, it should be noted that while section 105(a)(2) literally speaks only of the assisted municipality submitting "a plan for bringing its operating expenses into balance with its recurring revenues", the Board, in assessing the soundness of the plan, clearly must take into consideration both capital investment requirements and the capacity of the municipality to retire its long-term bonded indebtedness at a reasonable rate.

Section 105(a)(3) requires the applicant State to demonstrate—

> that it has the authority to control the fiscal affairs of the assisted municipality for the entire period during which the Federal guarantee will be outstanding including the authority to determine all revenue estimates, set aggregate expenditure limits, disapprove all expenditures not in compliance with the plan * * * and approve all borrowing and contracts during that period.

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

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

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

§ *106. Guarantee fees.*

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

§ *107. Limitations on amount of guarantees outstanding.*

This section limits the amount of outstanding guarantees of long term securities to $5 billion in the period from date of enactment to 1989, and to $3 billion from then until 1999. The dates and amounts provided in this section set forth the outer limits which your Committee believes should be provided in order to enable the Federal Government to deal prudently with a postdefault situation in which the nonguaranteed private market would be effectively closed to the City for an indeterminable but substantial period of time. They are intended for use under a financial plan which contemplates full payout without resort to refunding. To enable the City to get through the immediate postdefault period, there is authority for the guarantee of up to $2 billion in short-term obligations prior to October 1, 1978.

Section 107(c) sets an outer limit of September 30, 1999 for the fiscal maturity of any guaranteed obligation.

§ *108. Obligations callable after three years.*

Because of the interplay between this section and the other provisions of the bill, it seems unlikely that any Federal guarantees will remain in effect for the full period allowed in section 107, even if some are initially issued for that period. If there is a substantial failure to carry out the plan for a balanced budget which is required to be submitted to and approved by the Board under section 105(a)(2), then there will almost certainly be a call on the Federal Government to make good on the guarantee. Shortening the permissible guarantee period would not help to avoid this result, and may tend to make it more probable by biasing the financial plan in an overly optimistic direction. On the other hand, if the plan is in fact carried out for a substantial time and the City re-establishes a history of meeting its obligations when due, it seems reasonable to anticipate that the private tax-exempt market will reopen to it. At that time, it should be financially advantageous to the city to refund its taxable guaranteed obligations with nonguaranteed tax-exempt securities, and if this is done, the Federal Government would thereby be relieved of its contingent liabilities under the guarantees.

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

§ *109. Additional terms and conditions.*

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

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

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

§ *110. Audits.*

This section authorizes audits by the General Accounting Office either at its own initiative or at the request of the Board. Such audits may be made not only of the municipality directly, but any other agency or instrumentality of the State or municipality that either the Board or the General Accounting Office feels should be audited. Under authority of a similar provision in the Emergency Loan Guarantee Act (15 U.S.C. 1846(b)), the General Accounting Office has made extensive use of audits made by an independent auditing firm, subjecting these to such checks for completeness and accuracy as it deemed appropriate. Under the legislation herewith reported, your Committee would expect the General Accounting Office to make use of State and any other available audits, but to continue to exercise its own critical and independent judgment as to their adequacy, and to make audits of its own wherever necessary.

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

§ *111. Emergency Municipal Debt Guarantee Fund.*

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

§ *112. Federal Reserve banks as fiscal agents.*

This section requires Federal Reserve banks to act as fiscal agents of the Board at its request. A similar provision in the Emergency Loan Guarantee Act (15 U.S.C. 1849) appears to have been construed broadly in terms of the range of services which the Board may obtain under it.

§ *113. Protection of Government's interest.*

This section authorizes legal action by the Attorney General to enforce any rights accruing to the Government as a result of the issuance of guarantees; and provides that the Government would be subrogated to the rights of any creditor whose claim was satisfied pursuant to the guarantee. It also reserves to the United States the right to offset against any sums owing to a State or political subdivision for whose benefit any guarantee is made under this title, the amount in whole or part of any payment actually made by the United States pursuant to any such claim. Discretion is vested in the Board as to the manner and extent that this right of offset would be exercised, because it is clear that the right of offset might arise under circumstances where its immediate and substantial exercise would only exacerbate the problems and increase the expenses of the Federal Government as a whole.

Finally, this section authorizes the Board to increase the guarantee fee (up to a maximum rate of 2.25 percent per annum) whenever there is a failure of the political subdivision or the obligor of any securities issued for its benefit to fulfill any commitment or undertaking which it agreed to fulfill in consideration of the issuance of the guarantee by the Board. The purpose of this provision is to give the Board a means to bring about the correction of shortcomings before they become critical.

§ *114. Reports.*

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

§ *225. Termination.*

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

TITLE II—AMENDMENT TO INTERNAL REVENUE CODE OF 1954

§ *201. Taxability of certain federally guaranteed obligations.*

This section amends section 103(a)(1) of the Internal Revenue Code of 1954 to provide that interest on obligations guaranteed under Title I would be subject to Federal income taxation. The exclusion from gross income which the Revenue Code provides for interest on State obligations is not subject to waiver by the issuer of such obligations, and in the absence of this section of the bill, or some other provision having the same legal effect, it would be impossible for the State to comply with the condition set forth in Title I that guaranteed obligations must be taxable.

Committee Vote

On November 3, 1975, your Committee ordered H.R. 10481 favorably reported by a roll call vote in which 23 votes were case in favor of, and 16 votes were cast against, the motion to report the bill.

Estimate of Costs

In compliance with Clause 7 of Rule XIII of the Rules of the House of Representatives, there is set forth below an estimate of costs which would be incurred in carrying out H.R. 10481 in the current fiscal year and for each of the subsequent five fiscal years.

Administrative Costs

On the basis of experience with somewhat similar activities carried out by the Emergency Loan Guarantee Board and the General Accounting Office under the Emergency Loan Guarantee Act, the costs of which have ranged between about $240,000 and $142,000 per year, your Committee estimates that the administrative costs involved in the implementation of the bill herewith reported would be less than $1 million per year.

Guarantee Exposure

In the event that the entire guarantee authority is utilized, that there is a total default on all obligations so guaranteed, and that no recovery is made of any sums paid out under the guarantee, the maximum possible costs to which the Federal Government could be subjected would amount to $7 billion. Since the guarantee authority will be utilized on a piecemeal basis rather than all at once, it is likely that if difficulties do develop, they will do so well before the maximum permissible guarantee authority has been used. Moreover, in view of the limited purposes for which guarantees can be issued, the strict conditions of eligibility which must be met, and the continuous monitoring of the situation which will be carried on by the Federal Intergovernmental Emergency Assistance Board, the General Accounting Office, and by New York State's Emergency Financial Control Board, as well as the provisions in the bill for recoupment from other Federal payments of any sums actually paid out under guarantees, the likelihood of any ultimate cost to the Federal Government is small. Your Committee accordingly estimates that no costs will be incurred in carrying out the bill, other than the administrative costs referred to above.

Guarantee Fees and Additional Income Taxes

Assuming that the Board were to approve applications in such amounts that the average total guaranteed obligations outstanding would be as set forth below, and assuming that the Board were to assess the full authorized guarantee fee of 0.75 percent per annum, the Federal Government would receive guarantee fees as indicated in the following table. On the assumption the guaranteed obligations were held by taxpayers having an effective average marginal rate of 20 percent, additional tax revenues would flow to the Federal Government in the amounts shown under the heading below. Although tax-exempt municipal obligations typically appeal to higher bracket taxpayers, the 20 percent figure was selected on the assumption that a substantial portion of the federally guaranteed debt would be held by pension funds and others whose incomes sheltered from current taxation.

[In millions of dollars]

Fiscal year	Approximate average outstanding guaranteed obligations	Income taxes	Guarantee fees
1976	1,400	21.0	10.5
1977	3,350	50.0	25.0
1978	4,100	61.5	31.0
1979	4,400	66.0	33.0
1980	4,325	65.0	32.0
1981	4,175	63.0	31.0
Total	NA	326.5	162.5

Net Cost

Since the increased revenues which will result from the enactment of the legislation vastly exceed any possible costs of administration, and will probably exceed any ultimate cost to the Government even if

Inflationary Impact

some portion of the guarantee must be paid, your Committee estimates that no costs will be incurred in carrying out the legislation.

The bill provides for no new spending authority. By preventing or mitigating the disruptive and wasteful effects of default on the provision of essential municipal services and facilities, as well as on capital markets, and thereby reducing the ultimate cost to the taxpayers of the country of New York's fiscal difficulties, your Committee has concluded that the enactment of H.R. 10481 will have no inflationary impact on the national economy and can be expected to have a counter-inflationary impact.

Changes in Existing Law Made by the Bill, as Reported

In compliance with clause 3 of Rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows, new matter is printed in italics, existing law in which no change is proposed is shown in roman):

SECTION 103 OF THE INTERNAL REVENUE CODE OF 1954

SEC. 103. INTEREST ON CERTAIN GOVERNMENTAL OBLIGATIONS.

(a) General Rule.—Gross income does not include interest on—

(1) the obligations of a State, a Territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia, *except in the case of an obligation whose payment is guaranteed in whole or part under authority of section 103 of the Intergovernmental Emergency Assistance Act*;

(2) the obligations of the United States; or

(3) the obligations of a corporation organized under Act of Congress, if such corporation is an instrumentality of the United States and if under the respective Acts authorizing the issue of the obligations the interest is wholly exempt from the taxes imposed by this subtitle.

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ADDITIONAL VIEWS OF HON. GARRY BROWN

Although I have joined many of my colleagues in the minority views expressed in this report since I feel those views provide a good factual representation of the New York financial situation, I feel it essential to add some further comments.

Both the bill reported by the Committee and the President's approach to a resolution of the New York problem contemplate a general answer to what I believe is a specific problem which should be dealt with in a specific, rather than general, way. I expressed this opinion at the time the President made his proposal and incorporate herein that statement:

Washington, D.C.—I am disappointed with President Ford's proposal with respect to the New York City financial situation.

Although the President's proposal to a certain extent tracks, in theory at least, my general view of the extent to which the Federal Government should be involved in assisting New York with its financial problems. I think the mechanics contemplated by the President's proposal are ill-conceived.

President Ford in his remarks to the National Press Club on Wednesday stated that he was submitting to the Congress special legislation to provide a new Chapter XVI to the Federal Bankruptcy Act which would authorize proceedings by a municipality such as New York to avail itself of the debtor protections and financial supervision of the bankruptcy law. Under the amended law as proposed by the President, New York City would be able to effect an adjustment of its debts with its creditors while permitting the essential functions of the City to continue uninterrupted.

To utilize a general law such as the Bankruptcy Act and to make a general amendment equally applicable to all municipalities, when the New York situation is actually unique and should be dealt with in a particular and specific way, just doesn't make any sense, is politically and psychologically unwise, and flies in the face of what theAdministration has been telling us about the New York City problem and its impact on the nation and other communities' debt issues for the past several months.

In short, although the Administration has been saying that New York's problem is the result of its own mismanagement not applicable to municipalities which have properly managed their affairs, it has proposed a remedy equally applicable to all municipalities; and, whereas the Administration has been saying a New York default would not have the chaotic impact upon financial markets, municipal bonds, and the nation generally, which some have been alleging, it adopts a remedial proposal which will authorize every municipality to default on its bonds and seek the cop-out of the amended bankruptcy laws * * * which, in turn, can have nothing but a detrimental effect on the sale of municipals since now every investor will know that "full faith and credit" really means "moral obligation," that is, a moral obligation of the city not to avail itself of a structured default under the bankruptcy law.

Instead of prompting all of the visceral reaction which will be provoked by the stigma of having gone "bankrupt" and provoking investor fear by including all municipalities under the bankruptcy law, the President should have proposed:

(1) a specific piece of legislation to deal with the New York situation and the New York situation alone * * * "An Act to Provide for the Financial Reorganization of the City of New York" would be my suggested title;

(2) this Act could track the provisions of the Bankruptcy Act and provide the same protection for municipal services and activities and the sharing of any loss by creditors as does the Bankruptcy Act; and

(3) the Act could provide for supervision of the financial reorganization by a specific Federal Court similar to that provided for under the Bankruptcy Act or for a more appropriately-oriented board, commission, or trustee.

Again, such an Act would not have the negative psychological impact that treating New York City as a common bankrupt would, nor would it suggest that we are opening the door to all municipalities to avail themselves of the provisions of the Bankruptcy Act.

In addition to that which I have suggested would be a better route to take in the New York City situation, I believe temporary additional funding for the City of New York will be necessary. In this regard, although I reject the concept of a direct Federal loan or a Federal guarantee of New York City obligations, I would consider not inappropriate the possibility of providing special advances of certain Federal funds to which the City will automatically become entitled. I have in mind general revenue sharing, community development, and welfare funds just to name a few. These advances would then be recouped through a reduction in ensuing years of the City's entitlements for those years. In this way, the immediate cash flow problem of the City would be alleviated, but recoupment of the sums advanced would be assured to the Federal Government and any financial reorganization plan would contemplate the reduction in budget inflows for such succeeding years under the provisions of the recoupment plan.

The advancing of entitlement funds in emergency situations is not unprecedented, whereas the guaranteeing of municipal obligations or the providing of direct loans to municipalities such as New York is unprecedented and would be a bad precedent at best.

The truly unfortunate thing about the New York situation is that friend and foe alike have looked only at simplistic solutions to a very complicated New Year City problem. Friends have advocated a direct loan or a Federal guarantee of the City's financing requirements and the Administration has proposed a simple resort to the bankruptcy laws. It's time we applied a little more expertise to the problem.

The bill we have reported, H.R. 10481, by providing a program of Federal guarantees and other structured relief available to all municipalities in the country, is subject to the same criticism I have previously expressed with respect to the President's proposal.

GARRY BROWN.

ADDITIONAL VIEWS OF HENRY B. GONZALEZ

It is not possible for any municipality to cease operations. Yet the Committee has been told that New York City would be forced virtually to suspend all essential services if it receives no financial relief. There is almost no indication that the City has left any financial stone unturned in its search for new funds, and almost no evidence that the City can escape default without some form of Federal assistance.

The record shows that it might be far less costly to the Federal government, and certainly more likely to assure that order and necessary services in New York can be maintained, if assistance is provided prior to default.

Yet I question whether this bill can produce the necessary relief, and I am troubled by certain aspects of the bill, even if it could be enacted over the veto that has been promised by the President.

Time and time again, legislatures have acted in haste only to repent at leisure. Emergency legislation is very often the father of bad law and worse precedent. I am sympathetic to the problems of New York. No one can deny that the City must carry on, somehow. No one can dispute the evidence that it would be cheaper for the Federal government to provide a helping hand now, to preclude the possibility that we might be called on later to finance the City's essential services directly.

But would this bill provide the necessary help, and would it be the correct help? I think not.

The President has clearly announced his intention to veto this, or any other bill that he labels (however incorrectly) as a "bailout." It is unlikely that this bill will even be passed by Congress prior to a default by New York, and even more unlikely that it could be passed over a veto before that time. Even supposing that these miracles took place, I doubt that the machinery to provide assistance to the City could be set up and placed into effective operation in time to rescue it from default and bankruptcy.

Beyond these practical constraints, I am troubled by some of the consequences of a loan guarantee. The bill provides that bondholders would be asked to renegotiate their notes, so as to prevent the windfall profits that would otherwise flow to people who have bought New York paper at a discount on the gamble that a guarantee would be forthcoming. Unfortunately, the renegotiation provision does not go far enough. I believe that no guarantee we enact should promise to do any more than preserve the capital that investors have placed in the securities thus underwritten. The Federal government might well wish to protect innocent investors; but it should in no way be called upon to provide profits to investors who have been imprudent or who are outright speculators. Therefore, I would limit any Federal guarantee strictly to the amount of cash that individuals have actually invested in the securities to be guaranteed. Payment of any difference between the cash investment and face value of the paper, or any interest on it, should be left up to the issuer. Otherwise, the Federal guarantee would tend to encourage the proliferation of unwise investments in questionable paper—which is certainly a factor that contributed to the problems of New York City. Had the investors blown the whistle sooner, the problems the City faces today would be far less severe. The terms of any Federal guarantee should take this into account, so that while capital would be preserved, prudent investment practices would also be encouraged. No Federal guarantee should provide anyone a speculative windfall or otherwise reward improvident and unsound investment. I will, therefore, offer an amendment restricting any Federal payment on a guaranteed security to the amount of cash actually invested by the holder of such a security.

I am disturbed also by the precedent that would necessarily be set by this legislation. It would alter in a profound way the relationship between the Federal government and municipal governments—not only New York, but all others as well. There are differences between the straits of New York and those of the Lockheed Corporation, but it cannot be denied that the Lockheed bailout fundamentally changed relationships between the Federal government and private enterprise. The case of the Penn Central suggests that the precedent was not a good one.

In this case, we are proposing to intercede directly with a city. Cities are the creatures of the States, and New York is no exception. Part of New York's problem is that the State of New York failed to live up to its responsibilities to New York City. The State went along with unsound practices, no less than did the big banks; and the State encumbered the City with burdens it could not support, even as it failed to ameliorate the social and economic ills that plagued the City. If the City was irresponsible, and that is clearly the case, then the State had a duty to correct the problem. Far from doing its duty, however, the State ignored some of the City's problems, enacted policies that compounded other problems, and did not discourage activities that it surely must have known to be unsound or even outright illegal. It is possible that a loan guarantee, by interposing the Federal government between the City and State, might well cause the State to think its responsibilities have been met, when in fact the State of New York must be given every reason to know that it must accept and carry out its full responsibilities toward the sound government of all its instrumentalities, not just some of them. I am not satisfied that the bill does keep in place the correct relationships between the Federal government and the States and Cities, nor between the States and their instrumentalities, including the cities. If, as I suspect, this bill would change in a basic way the relationships within our Federal system, it is a step that we should take only with the greatest of fear and trepidation. The precedent set by this bill would be large indeed, and almost no thought has been given to the extent of it.

The financial problems of New York City are real. The dangers of the collapse of any financial structure as large as that of New York City are clear. The potential costs of such a collapse, even if it is confined only to New York City, itself, are very great. And it cannot be denied that the essential services of the City will have to be provided for as long as the City exists, no matter what happens to its financial system.

I do not believe that we are faced with a choice between bankruptcy and loan guarantees. The costs and dangers of a bankruptcy cannot be assessed, but I think they are too great for us to gamble on. Loan guarantees on the other hand, raise questions that I cannot immediately satisfy. My questions, reservations and doubts will take more time than is presently available to satisfy.

My opinion is that there is a third solution. Some believe that New York City can save itself, or that the state can do so. I do not believe this to be true. Some argue that there is no other choice than bankruptcy or a Federal guarantee. I do not believe this, either. I do believe that the Federal Reserve could provide financial assistance to New York through its powers as enuemated in section 14(b) of the Federal Reserve Act. If these powers are insufficient to allow the City to restructure its debt and establish itself on a sound and responsible footing, they are at least great enough to permit the City to escape default, and to provide sufficient time for Congress to give this complex and vexing problem the kind of careful and deliberate attention that is required. Furthermore, the Fed can act immediately, and immediate help is what is required.

No one could seriously argue that the Fed is ill equipped to exercise its powers to alleviate this sore problem. The Fed is the wealthiest of Government agencies; its powers and independence are known, respected and even feared. Its staff is expert by any standard. Its Chairman and Governors are known for their sagacity and caution. Chairman Burns is, as anyone who knows him will attest, a man of great ability, and moreover one who has a stern and righteous sense of values. It would be unlikely that the Fed or its Chairman would countenance less than the best effort that New York could provide to make itself honest and sound.

I urge that the Fed act, as it can and as it has done in other financial emergencies. I believe that this is the only way to assure that New York does not become a financial and perhaps social disaster as well. Most important of all, I believe that action by the Fed would enable us to provide with all the necessary caution and deliberation whatever further Federal action—if any—that might be needed to rectify this problem, beyond its own ample powers.

In a crisis, there are dangers to be avoided. In this case, I believe that we have almost no chance that the bill will solve the problem, and a considerable one that if it should somehow meet the crisis, the action would be irretrievably wrong from both a fiscal and constitutional point of view.

HENRY GONZALEZ.

ADDITIONAL VIEWS OF HON. JOHN H. ROUSSELOT

New Yorkers have already helped themselves to benefits which go far beyond those available anywhere else in the country. Although Federal and state welfare laws impose a higher percentage of welfare costs upon New York City than some other cities must bear, New York City compounds this problem by offering a much broader range of public services than any other city in the nation provides. The Congressional Budget Office, in a recent report on New York's fiscal problems, stated:

> New York's long tradition of providing enriched levels of public services also has contributed to its current fiscal difficulties. The more obvious services in which New York far outdistances most other local governments include the university system, the municipal hospital system, the low- and middle-income housing programs, and the extensive public transportation network. For many years there seemed little doubt that the city's wealth was sufficient to support its chosen level of services. However, in recent years, it has proved difficult politically to reduce services in line with the city's declining relative fiscal ability to afford them or to raise taxes and fees.[1]

Another major cause of New York's present fiscal problems is the advanced development of municipal employee unionism, which has created a situation in which elected officials have found it expedient to be open-handed rather than to stand up to union demands. The fact that municipal employees not only have the right to strike but also constitute the most vocal and best organized voting bloc in the city results in a reversal of the normal employer-employee relationship which makes it difficult, if not impossible, for the administration to manage the city in the broad public interest.

The October 27, 1975, issue of *New York* magazine contained an article which chronicled "Twenty Critical Decisions That Broke New York City." Among those twenty events were the following:

> *5. March 26, 1960: Governor Rockefeller signs a bill increasing by 5 percent the state's contribution to state employees' pensions.*
>
> On the face of it, this appears to be a minor decision with small immediate dollar consequences. But, in fact, this decision signaled the beginning of a process of leapfrogging, of open competition between the city and state to outdo each other in rewarding their servants. The bill for the first time made pensions a part of collective-bargaining settlements and invited competition among public unions. * * *

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[1] *New York City's Fiscal Problem: Its Origins, Potential Repercussions, and Some Alternative Policy Responses:* Background Paper No. 1, Congressional Budget Office, pp. 13–14.

The financial consequences of the 54 pension bills passed between 1960 and 1970 are staggering. In 1961, according to the State Scott Commission, the city paid $260.8 million to provide its employees with retirement and social security benefits. By 1972, that had jumped to $753.9 million, a growth of 175 percent. The rapid increase in city employment accounted for only 30 percent of this increase.

This year, the city budget for retirement benefits is $1.3 billion. But not even that sum gives the whole story. The business-oriented Committee for Economic Development has calculated that when all the city's costs—including hidden ones—are figured in, pensions will cost about 25 percent of payroll. And the payroll itself now consumes 60 percent of the city's budget.

* * * * *

12. January 4, 1967: The city's Office of Collective Bargaining names an impasse panel to settle a pay-parity dispute.

In 1967, faced with a tough quarrel involving old and sensitive relationships—"parities"—within police ranks, and between police and fire pay scales, the city's Office of Collective Bargaining named an impasse panel to sort out the issues. There followed the city's breaking of a written agreement with the police, a lawsuit, appeals, rehearings, and a six-day police strike in 1971. Ultimately, the city lost a suit brought by the Patrolmen's Benevolent Association, and the financial consequences were great. "By the time other groups, like firemen and sanitationmen, came forward with their related demands," writes professor Raymond Horton in his book *Municipal Labor Relations in New York City*, "the cost to the city was considerable—estimated from $150 million to $215 million."

But the city paid another price for its parity debacle. The city had previously suffered strikes by its transit workers, its teachers, sanitationmen, welfare workers. But until January, 1971, it had been almost unthinkable that those responsible for public safety would strike. With that strike went another piece of the social fabric, encouraging citizens and investors alike to lose confidence in the city's future.

New York can help itself to overcome its present fiscal difficulties by renegotiating its labor contracts, as well as its agreements with vendors and with holders of municipal securities. On the other side of the ledger, New York needs to increase its revenue base by abandoning its senseless rent control policy, which discourages improvement of the taxable housing stock; by reducing its involvement in massive public construction projects, which remove valuable property from the tax rolls; by improving its business climate, which continues to deteriorate and to drive taxpaying industry from the city; and by imposing user fees for such presently free services as university education.

ALLEGED CONSEQUENCES OF A NEW YORK DEFAULT

There has been a tremendous amount of controversy over the probable, possible, and likely effects of a default by New York City. It must be said, in all candor, that no one really knows what the consequences will be and that the only prediction which can be made with certainty is that, "The market will continue to fluctuate."

Noted experts on financial markets disagree. Chairman Arthur Burns, of the Federal Reserve, in his testimony before the Subcommittee on Economic Stabilization, described the probable effect of a New York default as "temporary and manageable." Norman H. Reamer, of Putnam Management Co., provided this prediction for the "Abreast of the Market" column of the November 3, 1975, *Wall Street Journal:* "Even if the city defaults, we don't think it would have an enduring impact on the nation's economic recovery."

Dr. Pierre Rinfret, President of Rinfret-Boston Associates, collected comments from correspondents around the world, and, in his testimony before the Subcommittee, disclosed the results of his survey. It is true that his correspondent in Hong Kong replied, "My opinion would be catastrophe (sic) effect internationally," and correspondents from Switzerland and Germany were also pessimistic. However, Dr. Rinfret also received the following responses:

> From Japan: "Where and what is New York? So far New York woes haven't caused even a ripple in Japan's capital markets, although the news is amply covered in the press."
>
> From Belgium: "We don't think the eventual default of N.Y.C. will have any direct influence on the financial markets in Belgium."
>
> From Mexico: "Immediate financial reaction to New York default in Mexico would be almost negligible."

Other observations and predictions of dire consequences of a New York default tend to be short-sighted and one-sided. For example, we have repeatedly been told that states and municipalities have recently encountered increased difficulty in floating their bonds and that this is evidence that the market is not working. What difficulty has occurred may very well reflect the fact that the volume of municipal borrowing has increased from $11.2 billion in 1960 to $51.8 billion in 1974,[2] and there are signs that the market for state and municipal bonds is becoming saturated.

However, it must be recognized that there is another side to a fair description of conditions in today's capital markets. States and municipalities which have good reputations for fiscal responsibility are finding that the market is rewarding them handsomely. For example, the Washington *Post* reported on October 23, 1975, that both the State of Maryland and the County of Fairfax, Virginia, had been able to sell their bonds to yield the lowest interest rates since February 1973:

> The state of Maryland and Fairfax County sold more than $95 million worth of bonds yesterday at interest rates sub-

[2] *The Bond Buyer's Municipal Financial Statistics*, vol. 13, June 1975, p. 7, as quoted in Library of Congress research report, "Debt Financing Problems of State and Local Governments," Oct. 3, 1975.

stantially below those they have paid in recent years, indicating that New York City's financial crisis has not had an adverse impact on all municipal bond sales.

William S. James, Maryland state treasurer, said that, contrary to his original fears, New York's problems appear to have actually helped his state rather than hurt it. This is because, James said, New York City's difficulties "make us look better."

Wall Street investment bankers contacted yesterday said that both Maryland and Fairfax have excessant reputations for fiscal integrity and that investors are sophisticated enough to differentiate between them and other jurisdictions, such as New York, where major problems exist.

* * * * *

Officials in both Annapolis and Fairfax were apprehensive about the bonds sales and the interest they would have to pay. After the bids were opened, there was jubilation.

Interest rates on Treasury bills declined during the week of October 27, 1975, to the lowest rate since June.

It is evident, therefre, that what is taking place is a "flight to quality," not a general distintegration of the market for government debt.

Learned speculation on the likely effect of a New York default upon the national economy, and upon prospects for economic recovery, comes from a recent study entitled "New York City's Financial Crisis," which has been issued by the Joint Economic Committee:

> While it is difficult to ascertain precisely how New York's financial crisis will effect the national economy, it is very possible that a default could weaken the strength of the economic recovery. The major factor in a weaker economic outlook would be a significant reduction in the rate of growth in State and local government expenditures. This reduction in state and local government spending will result primarily from higher borrowing costs and reduced access to the municipal bond market.
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> * * * * *
>
> Finally, some State and local governments may be forced to reduce their operating expenditures and bring their budgets into balance. The recession has caused some state and local governments to borrow this year to fund small deficits, in the hope that the recovery will generate sufficient revenues next year to return their budgets to balance. If these governments are denied access to the credit markets they will be unable to fund their deficits and forced to adopt some combination of expenditure cuts and tax increases to bring their budgets into balance. (Pp. 55–56.)

The JEC goes on to proclaim that it has conducted an econometric analysis, with the assistance of the Wharton econometric model: "The result of this econometric analysis, modified by staff judgments, suggests that a default by New York City could have a meaningful effect

on the recovery process." The JEC study predicts a reduction in GNP of 1 percent by the fourth quarter of 1976, an increase in unemployment of .3 percent, and an increase in the Federal deficit of $4 billion. (P. 56.)

It is astounding that the JEC seems to be telling us that government should be viewed as just another growth industry and that we should view any slowing of that growth as an alarming sign of economic stagnation. The JEC econometric analysis ignores the fact that the funds which the capital markets may deny to New York City will not vanish into thin air, nor will they be buried in the sand. Rather, they will be available for the use of other borrowers—to create jobs and to fuel the recovery.

H.R. 10481—INVOLVEMENT THROUGH 1999

Finally, it is important to note that H.R. 10481 authorizes guarantees of obligations of up to $5 billion from date of enactment through September 30, 1989, and of $3 billion from October 1, 1989 through September 30, 1999. These authorizations would permit the Federal government to be involved in the guarantee of eligible obligations for the rest of this century. They would permit those holders of New York securities who guessed wrong about the ability of the city to meet its obligations to recover in full and would permit those recent purchasers who may be speculating on Congressional approval of an assistance package to reap a windfall profit. Meanwhile the ordinary taxpayer, who took no position at all, would be stuck with a piece of the "Big Apple."

Such a protracted and extensive involvement on the part of the Federal government in the fiscal affairs of New York is entirely unwarranted and would be inconsistent with our national commitment to the principles of free enterprise and local self-government.

J. H. Rousselot.

ADDITIONAL VIEWS OF HON. CHALMERS P. WYLIE

New York City has asked Congress to pass a law which would commit the American taxpayer to become a cosigner for the payment of bills brought on by New York City's profligate spending. No matter how much time New York City can buy through financial acrobatics, it must inevitably face the simple arithmetic of the balance sheet. In view of New York's past fiscal sins, emergency help by the federal government in the form of loan guarantees, bond reinsurance, or direct grants would set a bad precedent for the rest of the nation. Ultimately, the solution rests either in the City of New York putting its financial house in order or going through the bankruptcy court where referees can piece together the framework for a financial rebirth.

New York City is in financial trouble because of excessive spending brought on partly by periodic strikes by teachers and public employees which are in direct violation of the law. Somehow we must as a people and as a nation stand up against this kind of tyranny. It may be that the New York City crisis is a blessing in disguise. We see what can happen to a great city when its elected officials respond to demands from irresponsible labor leaders and for more and more funding for welfare and social programs so that they have spent money beyond revenues.

Just recently, the firemen in Kansas City, Missouri, went out on strike. There were reports which were not refuted that some of the firemen actually set fires to force their demands for higher wages. The Mayor and the City Administration went along with their demands after first saying they were excessive. The same thing happened in San Francisco. This is very distressing to me when the elected public officials in charge of running the government in those cities are afraid to do what is right and succumb to power brokering of the worst kind.

Fiscally, New York City is a study in desperation. Correctly identifying the cause of this financial Waterloo is a major step in arriving at a solution. Rather than allocate blame, it becomes necessary to catalogue and weigh the misdeeds of the past decade. Of course, the immediate problem stems from the loss of investor confidence in New York City obligations.

Budget Mismanagement

Initially, I note the budgetary practices of New York City officials have been somewhat suspect, to understate the matter. Some have described these practices as accounting "gimmickry." Were an officer of a private corporation to engage in the same practice, he would be hard pressed to avoid an indictment.

By law the city's budget is required to be balanced. Uncontradicted evidence shows that current operating expenditures were hidden in the capital expenditures budget, thus giving the appearance of fiscal equilibrium. The practice was camouflaged by issuing more revenue anticipation notes than could be amortized through actual revenues. To meet the monthly gaps between expenditures and revenue the city "rolled over" its debts and borrowed more to meet current expenses. The 2.6 billion dollar deficit represents an aggregate of the past decade of current operating deficits. Because the city borrowed so frequently, it was forced to go into the market at a most unattractive time, thereby compounding its mismanagement.

Frankly, I am astounded that city officials permitted this disgrace to continue. The handwriting has been on the wall for ten years.

Champagne Life on a Beer Income

Per capita expenditures for public services at unheard of levels contribute significantly to the city's financial ills. One person in eight is on welfare in New York City. Public assistance has become a way of life, rather than a temporary staging area for people to become self-reliant. The extreme levels of aid to the jobless is an inherent disincentive to work.

Under the publlic service umbrella come totally free education, from elementary school through college, a huge network of public hospitals, and heavily subsidized mass transportation systems. No city in the United States runs a university system like New York. Needless to say, the city invites fiscal chaos because tuition at the university is virtually free to its 265,000 students. The city pays half the $600 million budget with the state picking up the rest. Another frightening revelation is the fact that one-third of the employees of the city's Board of Education do not teach.

Huge and costly public hospitals, eighteen of them, have one-quarter of their beds unoccupied, while the government pays millions for patients using private hospitals. Mass transportation costs have been kept at artificially low levels for years on end.

Overpaid Government Employees

Wage contract settlements for public employees have been excessive. Many city employees can retire after 20 years at half pay, with the pension determined by their last year salary plus overtime. All too often the story has been 19 years of mediocrity with a final year of demon activity to beef up the retirement. Pensions cost the city about a billion a year already. By 1980 projected pension costs will equal two billion per year. And, the astonishing fact is these are noncontributory while in most other areas private and public employees pay half of the pension.

Statistics show that public employee productivity is a farce. It costs New York City $45 a ton to pick up garbage, while in San Francisco it costs $22, in Boston $19, in Minneapolis $18, and in Columbus, Ohio, approximately $18. Many have claimed that New York is different, unique, or special. Can we also say that New York City's garbage is also special?

After one year, public employees are authorized unlimited sick leave and one month's vacation.

Rent Control Law

New York's rent control law, adopted at the end of World War II, causes 30,000 apartments to be abandoned each year. A change in the law might bring part of its middle and upper class tax base back to the city.

Unnecessary Duplication of Services

Many city agencies unnecessarily duplicate state services. Some duplicative programs could be abolished in view of current fiscal problems, drug addiction centers, Department of Correction facilities, municipal broadcast systems, vocational counseling, and boards of examination for teacher certification are some examples. All this adds up to the whopping sum of $172 million a year.

All of these occurrences were within the city's power to control. Because the city failed to exercise control, a chain reaction has taken place. For instance, it is quite understandable that the middle and upper class tax base have fled to the suburbs. Businesses have left the crime ridden city center, and have taken valuable jobs along with them. Because New York chooses to rely primarily on income and sales tax rather than property tax, it is overly sensitive to business cycles.

Default Impact

Since the city has petitioned the federal government, the question is what is best for the country. We are going to set a precedent for every other city in the United States.

In this connection we must be mindful of the people in those cities that have kept public services in line with their ability to pay and who have lived with balanced budgets. Geographically, the impact of a default will be confined to the New York City area. Inasmuch as New York City bonds are exempt from federal, New York State, and New York City taxes, it stands to reason that most of these bondholders live in New York.

Collapse of the municipal bond market is the heart of New York's appeal for direct assistance. I think the consequences of a default have been exaggerated to dramatize the appeal for federal aid. Most persons are aware of the fact that the welfare of the municipal bond market is tied to the national economy. Furthermore, it is the function of the market place to sort out and evaluate credit risk. Cities that are well managed and financially responsible will find investors beating at their door regardless of what happens to New York City. Recent issues of municipal bonds in several cities bear this out. Within the past two weeks, the City of Columbus, Ohio, sold $18 million worth of municipal bonds at 4¾ percent, the lowest rate in five years. Moreover, federal intervention in behalf of New York would be more chaotic for the market in the long run because bond values would not hinge on credit worthiness but rather on federal guarantees. There would then be no incentive for fiscal restraint.

The Federal Reserve Board, the FDIC, the U.S. Treasury, and the Comptroller of the Currency have standby authority to assist banks whose portfolios are heavy with New York City obligations. Thus, there will be no domino effect in the financial markets.

Fairness and the Restoration of Confidence

The American people know why New York City is having a financial breakdown. They also know it has little to do with the difficulties and conditions of our national economy. The city is facing default because it has not shown itself willing to implement the necessary reforms to restore investor confidence and regain access to capital markets.

All to often there is a tendency to run to Washington to solve internal municipal problems. If Uncle Sam does not come to the rescue then the blame is conveniently and cleverly shifted to Washington by those at fault.

One question which is difficult to answer is how can we reconcile the billions we spend in foreign aid, the billions for defense, and chronic deficit spending and say no to New York City. The short of it is that we cannot reconcile them. However, a multitude of wrongs do not make a right. Congress must realize that the federal government cannot play world gendarme and world Santa Claus. Furthermore, merely because it has the monetary printing presses it cannot continue to engage in deficit spending. Our national day of reckoning is just a little further down the road from New York City if we do not heed the warning sign.

C. Wylie.

ADDITIONAL VIEWS OF HON. STEWART B. McKINNEY

I wish that it was as easy for me to determine that only minimal difficulties will arise from the default of New York City as it appears to be for the President, and some members of the Administration and Congress. However, after 5 days of hearings, which included testimony from a broad base of specialists in municipal financing, national and international banking and academia, I have concluded that the default of New York will bring chaos not only to New York City but the fiscal failure of the nations greatest city will have unestimatable consequences on a national and international scale.

I suppose that because my district is in close proximity to New York City, I can be accused of being emotionally involved with the city's future. However, my concern for New York's plight is more a result of my representation of 3 cities who someday may find the municipal credit market closed to them. My statement at the outset of hearings on the problems of municipal debt financing indicated my belief that the hearings were not specifically geared toward saving New York City, but rather the plight of municipalities across the Nation.

It's interesting to note that in July of 1973, the Advisory Council on Intergovernmental Relations issued a study on the financial stability of America's cities. At that time, the Commission reported that no financial crisis existed for the cities but a combination of factors relating to services, taxes, wages and retirement benefits made several cities susceptible to financial emergencies. In discussing the available alternatives, it was suggested that appropriate action to revise the method of handling municipal crisis of this nature be taken then—when the cases of financial distress were few—so that a well reasoned plan could be devised. Had this advice been heeded, we would not now be faced with what has sadly become the rule, not in the exception, government by crisis.

Furthermore a study of municipal defaults during the Depression and their causes read like a litany of today's municipal problems: Demands for increased services, reluctance to increase taxes, overdevelopment of real estate and—perhaps most significantly—a lack of responsible fiscal management. If the basic problems are parallel, the economic situation facing the country contains alarming similarities also. I do not intend to recount the problems so familiar to us all. I feel it is sufficient to observe that the present recession has placed the United States and the world on the weakest economic foundation in forty years.

What I attempted to do, during these 5 days of hearings was to evaluate both sides of the issue to determine precisely what the financial and psychological effects of default would be. It was surprising to me that even those of the Administration who were so firmly against bond guarantee assistance continually indicated that they did not really know what the psychological effect would be on either the bond market, on the stock market, on the international markets or on our infant economic recovery.

In 1974, there were 7,701 issues of long and short term state and local bonds with a par value of 51.9 billion. The total amount of tax exempt securities outstanding at the end of this period was $207 billion. The value of tax exempt obligations issued yearly between 1960 and 1974 has increased nearly five fold. Thus the tax exempt bond has become institutionalized as a means of securing added capital for municipal expenditures. This capital is used to refund debt, for short term borrowing in anticipation of tax receipts, for the construction of schools, hospitals, roads and other capital improvements.

It was made quite clear during testimony from municipal finance specialists that without the ability to go to the bond market for capital, municipalities would not be able to provide required public services and eventual collapse would result. Thus, a report by Standard and Poor's indicating that ten percent of the nation's municipalities are unable to enter the financial markets at all, as a result of the psychological effect which default is having on the bond market, is to say the least disturbing.

Moodys Bond Survey further reports that high rated municipal issues are at record yields, while the national association of counties states that smaller localities across the nation are paying higher interest rates than ever before. Simple calculation indicates that even if the psychological effect of default causes a one percentage point increase in the cost of local borrowing, it will result in an additional $1.84 billion in interest charges over the 8 year average life of municipal bonds offered over a one year period.

Thus while those who oppose a federal guarantee claim that they do not want to provide "one red cent to New York," all municipalities and therefore all taxpayers are already paying the price for inaction.

With the importance of the tax exempt market to most municipalities, it is vital that investor confidence is maintained. Unfortunately, that confidence is decidedly absent today and it is unrealistic to assume that defaults today will be met with passive acceptance by creditors. Call it a "domino" or "ripple" effect if you will, default by a major municipal borrower can be expected to trigger a confidence crisis of potentially disastrous proportions for all tax-exempt bonds, no matter how sound the backing.

Concern over the psychological impact on international markets has also been expressed in recent weeks by various authorities. Recently, London's Deputy Mayor stated that "a default by New York would result in a massive tragedy" for the Western world and possibly signal the end of self government by all democratic cities. Former Undersecretary of State George Ball told our Subcommittee that "default of a private company is, as foreign countries see it, a phenomenon quite normal in the operation of a capitalist system; but for the Federal government to sit by immobilized while one of the great cities of the world defaults on its obligations, would, however unfairly, raise questions as to the integrity and good faith of our political authorities and create doubts as to the responsibility of our national government and, hence, the validity of its promises."

Dr. Pierre Rinfret, a noted international financial consultant compiled correspondence from top financial people in Europe and Asia inquiring as to the effect of a default on foreign markets. The response from Switzerland; "nobody can evaluate what the psychological reaction could have been, but the Euro dollar market is very sensitive to charges in confidence and the consequences could be harmful; from Germany . . . "There would be a very strong psychological negative impact.' If New York fails anything else may fail. It would certainly further shatter the belief in the American economic upswing which anyhow is weakening." And from Hong Kong "My opinion is it would be a catastrophic effect (sic) internationally."

While other responses indicated the opinion that this would be a minimal effect on international markets, it is still evident that severely adverse reactions could result.

What would the cost of default be in dollars and interational fiscal integrity be to the American taxpayer?

The impact of default on our economic recovery should be of utmost concern to every American. While default certainly cannot bolster our fiscal integrity, I have attempted to balance the claims of both sides of the issue. Again my opinion is that the cost to the American taxpayer will be more post default than predefault. However, in the case of our economic re-development, the cost will be more than dollars, the cost may well be an economic slump, more devastating than that which existed over the past 4 years.

The inability of a political subdivision to borrow in the credit markets has an obvious effect on municipal spending. Traditionally, this type of shortage forces a postponement of capital improvements which do not need immediate attention. However, it should be remembered that decisions of this nature have a debilitating effect on the needed encouragement for economic growth. Further capital expenditures for schools, hospitals and other public buildings may not be made, thus adversely affecting public services. Also, there is a possibility that firms using securities as collateral could find their access to bank financing restricted which would curtail business expansion and could lead to the failure of those that were overextended. Cities across the country unable to acquire needed capital have announced the cancellation or termination of capital improvement programs which would have resulted in cutting current high unemployment rates.

Banks holding municipal bonds could find themselves in difficulty, since it could reduce their liquidity and in turn, they might have to restrict loans to their best customers exclusively. Thereby, further limiting funds to corporations already closed out by our existing capital credit crunch. And what of the financial security of this nation's banking systems. Testimony from both the Federal Deposit Insurance Corporation and from the Comptroller of the Currency indicates a total of 324 banks which are holding New York City obligations which exceed 20 percent of their gross capital funds. Of these 324 banks, a significant percentage have 50 percent more of their net worth invested in NYC obligations. While both government agencies feel that only minimal problems will arise for these institutions from a New York City default, I am afraid that the fall of even a small percentage of the banks listed fail because of the default, serious psychological and resultant financial consequences will follow for our banking institution. A default by New York and subsequent financial difficulties for other municipalities can have only the most dire effect on our economic security. Even Frank Willie of the FDIC stated in his testimony "Obviously, the potential impact on non-member banks could become significantly more serious if other municipalities besides New York City were forced to default because of general turbulence in the markets for state and local obligations.

What will the cost of the failure of a percentage of our banking system mean in dollars and financial security to the American taxpayer.

My conclusion after carefuly evaluating the testimony of the witnesses before the Subcommittee is that the risks inherent in letting the largest city in the nation default are too great for me to take as a representative of 500,000 American citizens.

The President however feels that post default assistance will be less costly to the American people than a bond guarantee as proposed in this bill. Actually, a Federal guarantee will cost nothing and in all probability will provide added revenues for our federal treasury. This factor is evident from our experience with the Lockheed Loan Guarantee which has already netted the Treasury some $17 million. The loan guarantee fee and the submission of New York City and state revenue sharing funds as security for federal assistance more than adequately protect our federal interest.

An estimate of post default aid as suggested by the President, appears to me, to be the more costly alternative. Already the specter of New York City bankruptcy has taken its toll on some 1,500 companies that sell their goods and services to New York. For example, the American Seating Company of Grand Rapids, Michigan, the home down of our President, will start to lose over three quarters of a million dollars for seats which they provide for Yankee Stadium, if New York City cannot pay their bills. 500 million dollars of expected revenues to companies across the country, will not be paid. What will the cost of bad debt losses and lower corporate income tax dollars mean to our treasury.

It is estimated that default would necessitate lay-offs of an additional 30,000 city employees and partial payment of salaries for the rest. This figure does not include the thousands of lay-offs which will be caused by the cancellation of capital improvement and service contracts with the private sector. It is estimated that this will result in a New York City unemployment rate of over 20 percent. Thus, the lost jobs and the lost business to the cities vendors, could mean a $100 million tax loss for New York each month. This astounding municipal tax loss in addition to the increased unemployment and welfare payments which will come from our federal coffers, will cost the American taxpayers millions.

The President has also state that "In the event of default, the Federal Government will work with the Court to assure that police, fire and other essential services for the protection of life and property in New York are maintained." The problem with this statement is what services are considered "essential services" and what will the cost of providing these essential services be to the federal government.

In addition to the obvious life support services of police, fire and hospitals, will the federal government also provide personnel or funds for the continued functioning of the water supply, sewage treatment and sanitation services. And if so, at what cost to the American taxpayer?

In March of 1970 the federal government had to call out the National Guard to deliver the mail during the mail carriers strike. National Guardasman when called up for a period of 14 days at a cost of $2,528,749. What if the President in keeping his promise to "assure that essential services are maintained" would have to call out the National Guard. The expense to the American taxpayer could be exorbitant.

What of the cost in both time and money to the individuals who bring suit in federal court over the superiority of their lien against the city and state. It has been estimated by witnesses that the courts could take from 5 to 7 years to clear their calendars of lawsuits stemming from a New York City default. Once against demonstrating that the cost of post default is considerably more than a pre-default guarantee.

The psychological and financial consequences of post default aid in my opinion, are sufficient to convince every member of Congress that the crisis which New York is experiencing today will possibly effect every urban center in America in the future. The fiscal decay which has beset New York and the cities subsequent default will have an impact felt by every American. Mayor Beame has stated "that the question President Ford should ask himself is not 'who benefits from a New York default? "—but 'who loses?' Clearly there will be no winners."

At the outset of the hearings on this legislation I stated that "It is my hope that we will find that the federal government need not provide any direct federal payments to our ailing cities." Instead, I believe it is the responsibility of Congress to provide a medium for our cities to achieve fiscal stability, to restore confidence in their survival in order to establish normal funding channels. These hearings have convinced me that this is the minimum that the federal government can do to preserve the fiscal integrity needed for economic recovery and growth.

H.R. 10481 provides this medium in a most comprehensive, responsible and least costly manner.

STEWART B. MCKINNEY.

INDIVIDUAL VIEWS OF HON. RICHARD T. SCHULZE

A federal bailout of New York City, in the form of an $8 billion loan guarantee, has been proposed. The "Big Apple" has gone sour.

Irresponsible fiscal policies and financial legerdemain have brought New York to where it is today * * * facing an outstanding debt of $13 billion, over $3 billion of which is beyond budgetary authority. Taxpayers across the nation are now requested to assist the city of New York in the form of a loan guarantee. I cannot support this legislation which in effect condones excessive spending, questionable accounting practices, and irresponsible municipal leadership. Let us look at how New York City reached this current financial crisis.

To begin with, New York City has long been proud of its high level of public services. Extraordinary "free" services have been provided. New York City's mayor recently boasted that "Everybody agrees that New York City has always done more for its people than any other city in the world." Let us examine some of these benefits enjoyed by the residents of New York:

Tuition-free education at the city's 19 university institutions;

Free services at the city's 18 municipal hospitals;

Subsidized subway or transit fares;

The highest municipal wages in the country;

100 percent municipal payment for employee pensions; and

The most generous welfare payments in the nation (which encourage the immigration of thousands into the city to enjoy them).

It is outrageous that the American taxpayer is being asked to come to the rescue of a city which offers benefits which are not available to most people in the nation.

The bailout of New York City has been referred to in emotional terms and as a "moral" issue. Is it "moral" to saddle our constituents with the cost of $68,597 penthouse, complete with greenhouse, swimming pool and underground parking, for the "needy" in New York? Is it "moral" to coerce the American taxpayer into subsidizing the $713,500 in overtime pay to New York City employees which was necessary for the collection of refuse which had accumulated during a garbagemen's strike? The answer is a resounding "No!"

State and local governments across the United States have been making on an almost daily basis the hard decisions necessary to living within their means. Should these communities now be held responsible for the betrayal of public trust by New York City's municipal officials?

To disguise their financial predicament, New York City officials engaged in financial legerdemain approaching massive public fraud. It is interesting to note that the defeat of New York referendum bond issues by the public in 1964 and 1965, resulted in the creation of so-called "moral obligation" bonds. These bonds do not require voter approval. In that year, 1964, the Mayor of New York City remarked that he did not intend "to permit our fiscal problems to set the limits" on what the city would do for the people. At that time, the Governor approved legislation permitting the city to use its capital budget to borrow for current expenses. Following this, $26 million in expense items was buried in the city's capital budget. In the decade of 1965–1975, a total of $2.4 billion was smuggled into the capital budget. The added interest cost was $250 million.

There was also the practice of tax-anticipation borrowing on revenues which had already been collected. In the last two years, the city has issued revenue anticipation notes in the amount of $1.275 billion against $404 million in receivables.

A federal rescue of New York City would imply a tacit acceptance of the irresponsible municipal mismanagement in that city and would encourage other States and municipalities to follow suit. It would threaten the historical and delicate relationship between our federal, state and municipal governments. It would remove the necessity of municipal officials being held accountable to their electorate if they were insured federal assistance as a reward for a lack of fiscal restraint and budgetary sleight of hand.

It has also been advanced that a federal loan guarantee will be free * * * will cost the taxpayer nothing. This is not so. The costs in higher interest rates, higher mortgages, more expensive products, et cetera, would be very high indeed.

Beyond this, the threat of a municipal bond market collapse has been advanced if New York City is forced to default. We have been warned of the "ripple" effect. We have been told that municipalities from Pennsylvania to California will be unable to market their bonds. Recent experience would indicate otherwise. Kansas City, the State of Delaware, and Minneapolis Spec. S.D., have been low-cost short term borrowers at 3.67, 4.29 and 4.629 percent respectively. In addition, in late October of this year, the State of Maryland and Fairfax County, Virginia, sold more than $95 million worth of bonds at interest rates substantially below those they have been paid in recent years. I submit that there will continue to be a market for municipal bonds with sound ratings.

Finally, there is the question of what New York City and New York State have done for themselves. There remains the possibility of imposing an emergency and temporary tax, as well as authority to borrow funds collateralized by assets in employee pension funds. I am not convinced that the City or the State have exhausted their alternatives. There *are* other solutions.

For the reasons stated above, I cannot support this legislation and I urgently encourage my colleagues who believe as I do, that this proposal calls for shouldering the responsibilities which properly belong to the States and municipalities, to join me in opposing this measure.

RICHARD T. SCHULZE.

SUPPLEMENTAL VIEW OF HON. LEONOR K. SULLIVAN

I have serious reservations about this legislation, but I support it because it is the only measure immediately available to provide New York City and State with a means of avoiding default and, thus, protecting the municipal bond market from drastic erosion of confidence that could prove devastating to the credit needs of State and local governments across the nation.

H.R. 10481 is a one-shot bill aimed solely at New York City's financial dilemma. It completely fails to address the chronic and worsening credit problems which hobble State and local governments in their efforts to obtain adequate loan funds on reasonable terms to finance vital public works and facilities.

A review of financial news produces convincing proof that an increasing number of municipalities and other political subdivisions are steadily being squeezed out of the money market by steadily rising interest rates and a diminishing pool of investors. More and more local governments are finding that they cannot even float their bond issues because no bids whatsoever are received or that bids that are made carry demands for interest rates which exceed legal permissible limits.

I readily acknowledge that the circumstances in which New York City finds itself have had a significant adverse effect on the bond market. However, the long-term debt financing problems of communities throughout the country did not begin with New York and they will not end with the aid this bill would provide to that City.

The Congressional Budget Office confirmed this point in a paper it issued on October 10, 1975. The Budget Office stated:

> * * * New York's situation is far from the worst in the nation. One composite index of central city disadvantage shows New York in better shape than Newark, Baltimore and Chicago, as well as eight other large urban centers * * *.

What is clearly needed is a Federal agency which can make direct loans and guarantee loans to State and local governments when these borrowers cannot obtain adequate credit on reasonable terms from other lenders. Moreover, such an agency, serving as a lender of last resort, should be equipped to meet the national priority credit needs of small and medium size business and industry and moderate income housing which are also victimized by the lack of adequate credit on reasonable terms.

Indeed, the hearing record on H.R. 10481 is replete with examples and testimony which show the credit problems of State and local governments to be nationwide in scope and deserving of a legislative response that goes far beyond the boundaries of New York City or New York State.

William White, Executive Director of the Massachusetts Housing Finance Agency, which has been forced to cancel bond issues and drastically cut back the production of urgently needed housing throughout that State, testified:

> * * * I would like to propose that the Federal government establish an agency with a standby authority of $20 billion to become a resource capital fund. This agency could make direct loans or guarantee the purchase of tax-exempt securities at current market prices * * *. It would be a bank of last resort.

The fact that the problem is nationwide in its dimensions and requires such a nationwide approach is reflected in the testimony of none other than A. W. Clausen, President of BankAmerica Corporation, parent holding company of the nation's largest commercial bank. He testified that:

> The financial markets of the country are floundering, owing in considerable part to New York City's budgetary difficulties. The market for municipal bonds has been the most severely affected, with interest rates currently at the highest point in history. * * * The prohibitive cost of borrowing has forced the cancellation or delay of numerous housing and public works projects.

Bank of America recommends accordingly that:

> * * * a new agency should be created in the Federal government for the purpose of serving municipalities as a lender of last resort.

The solution these witnesses have advocated is embodied in H.R. 10452, which would establish an Emergency Financial Assistance Corporation to provide adequate credit on reasonable terms to State and local governments, to small and medium size business and industry and to finance low and moderate income housing when private lenders cannot meet these standards for priority area borrowers.

It is my hope that this proposal, which is cosponsored by 16 Members of the House, will be given immediate consideration by the Banking, Currency and Housing Committee. The need to do so is urgent.

LEONOR K. SULLIVAN.

SUPPLEMENTAL VIEWS OF HON. DAVID W. EVANS

In recent weeks Congress has given a great deal of attention and consideration to the financial quagmire facing the City of New York and the detrimental effects "default" would have on the prosperity and economic recovery of our nation.

I have very serious and very strong reservations about the State and City of New York's attempts to break through the maze of financial mismanagement and excessive public services to a path of sound fiscal planning and budgetary programming. Such a path must be based on the needs of the populace and the assets of the municipal and not on the whims of special interests and political expediency. Yet, while these bills of particulars are severe, I do not believe that they alone should condemn this legislation.

I am more alarmed by the Committee's decision to create the Intergovernmental Emergency Assistance Board, which in several ways is an affront to our legislative and democratic processes. This Board would be given wide sweeping authorities and controls to deal with the fiscal problems confronting a city in either a pre- or a post-default setting. Taken at face value the general autonomy of the Board would appear essential in dealing effectively and expeditiously with default issues. However, a thorough analysis of the provisions of this legislation reflects that there are virtually no checks or balances as to what a Board may or may not decide to do to or for a "default" city. We have heard a certain amount of discussion that the federal government stands to make money from this crisis in the form of guarantee fees (Section 106). The inference of the language in this section of the legislation is that the Board may impose as little as a one-dollar guarantee fee from the obligor. Certainly not a high profit making situation. On the other extreme, a Board has the authority to call for the redemption of any obligations guaranteed after three years (Section 108).

The point I am driving at is that under this legislation the Board could and probably would make any city falling into the default category and having no alternative but to seek federal assistance, a political hostage of the current Administration—no matter which political party may be in power. I am in full agreement that such a thing is very unlikely, yet the legislation would be setting a precedent for future actions of this type.

I firmly believe that we should take every precaution and make every effort to prevent further erosion of Congressional power over and control of the programs we have initiated. To do less than this is to shirk the mandate given to us by our constituents as well as the obligation we have to the Constitution.

DAVE EVANS.

MINORITY VIEWS ON H.R. 10481

The Good Life in New York City

The American public does not begrudge all the good life for the residents of New York that the City can provide and for which the City can pay. But the American public, in general, does reject the notion that the Federal Government should pick up the tax for excessive spending by New York politicians in providing vote-getting enriched public services that the City cannot afford.

The 86 million Americans who see their pay checks docked 5.85 percent each payday as their contributions to social security retirement find it hard to understand why New York City workers should have a free ride under the pension and retirement systems provided by the City which, in effect, are non-contributory systems. We would not want to have the job of trying to explain that set up to our constituents next fall, as we well might be called upon to do, had we supported this New York City bail-out bill.

Likewise, we would not want the job next fall of trying to explain to the parents of college and university students in our districts why it is they have to pay heavy tuition expenses each year while, under the good life program of New York City, free tuition is provided at City University which is one of the largest universities in the world. Any high school graduate, rich or poor, who wants to attend is eligible.

In addition to high salaries, New York City employees, under the good life, enjoy fringe benefits and paid retirements costs which average more than 50 percent of base pay. Four-week paid vacations and unlimited sick leave are provided for employees after only one year on the job.

No question about it. The good life is appealing if you can stretch your credit and don't have to face up to the question of paying for it. The numbers tell the story. In the past decade, New York City politicians have allowed the City's budget to triple. Expenses have increased by an average of 12 percent per year while tax revenues were increasing by only 4 to 5 percent a year. The moment of reality has arrived.

New York City Finances

We are told that even if no payments were made on principal and interest on debts of the City that there would be a cash flow deficit of approximately $1.2 billion in the next four months—December through March of next year. What we are not told is that such a cash flow deficit for that 4-month period is normal operating procedure under the way the books of the City are maintained. What we are not told is that the last quarter of the City's fiscal year ending June 30 is a lush revenue period with receipts substantially exceeding expenses including interest on debt. For instance, in the last quarter (April, May and June) of the City's fiscal year ending June 30, 1975, the City received 52.6 percent of its general fund revenues for the year and almost 40 percent of its total receipts excluding borrowing operations. For that last quarter of the fiscal year ending June 30, 1975, receipts of $5.063 billion exceeded expenses of $3.423 billion *producing a surplus* for the period of $1.640 billion. This surplus together with a drawdown of $103 million of cash and investment balances was used to reduce New York City's total debt from $14.050 billion as of March 31, 1975, to a total debt of $12.307 billion as of June 30, 1975.

In the light of additional facts, that $1.2 billion of cash flow deficit in the next four months is far less ominous than it appears standing by itself. The cash flow deficit for that period will be self-correcting from the excess of revenues over expenditures in the subsequent three-month period. Further, the cash flow deficit could be eliminated completely by more closely gearing receipts to the time frame of expenditures made. Get away from that revenue pattern under which the last quarter of the City's fiscal year produces 40 percent of its total receipts excluding borrowing operations.

Appendix A lists bonded debt of the City as of June 30, 1975, and cash receipts and disbursements for fiscal years ending June 30, 1975, and 1974 as reported by the City Comptroller.

Big MAC

There is in being and in place a financing mechanism created to stretch out New York City debt and provide the City with funds for operating expenses. This is the Municipal Assistance Corporation, familiarly known as Big Mac. It was formed in June of this year and as of October 20, 1975, had sold $2.677 billion of its bonds with maturities extending from 2–1–77 to 2–1–95.

Big Mac is a "moral obligation" agency formed under New York State law. Big Mac has no taxing power, was created initially without any assets and its bonds and notes in no way are legal debts of either New York State or New York City.

But subject to legislative action by the New York State Legislature, Big Mac is endowed with a valuable right; that is the right to receive funds from the State controlled sales and compensating use taxes imposed by the State on these transactions after July 1, 1975, in New York City. Such revenue, if appropriated each year by the State to a "Special Account" to service Big Mac debt, amounts to approximately $800 million per year. The State has appropriated such funds to the "Special Account" for the State's fical year ending March 31, 1975. So by February 1, 1976, when Big Mac will have $116.9 million of interest due on its $2.667 billion of bonds, the "Special Amount" will have funds available (on a pro rata basis) of approximately $466 million to meet that interest payment.

Since Big Mac is a creature of the State and *not* of New York City, Big Mac will *not default* on February 1, 1976 interest due even if New York City should default in December of this year.

After March 31, 1976, the "Special Acount" for Big Mac debt service, subject to annual State appropriation, can be augmented by the State stock transfer tax approximating an additional $195 million per year.

Big Mac is a versatile and ingenious financing device. When specific revenues are appropriated by the State each year, there will be available for the "Special Account" approximately $980 million to meet Big Mac debt service—principal and interest—which on the bonds now outstanding will peak at $428.1 million on 2–1–77. So long as New York State doe not default, Big Mac will have the capacity to completely service its debt on approximately a 2 to 1 basis. After building a Capital Reserve Fund from 1977 to 1980 equal to one year's debt service on Big Mac bonds, the excess revenues in the "Special Account" can be returned to New York City for current expenses. This could amount to upwards of $500 million a year to assist New York City in meeting its current expenses.

Billions of Assets

Until recently, the bililons of assets owned by New York City and New York State pension and retirement funds and sinking funds virtually have been ignored by the vociferous political and big banker advocates of a Federal bailout for New York City. Now that default by New York City appears to be an increasing possibility, active consideration of some use of the billions of assets of the City and State investment funds to avert defualt by New York City is coming to the fore.

The Comptroller of New York State has advised that the various pension and retirement funds of the State approximately $7.4 billion. Figures as to New York State bonded debt outstanding and such debt outstanding in the hands of public would indicate that another $750 million of assets are held in New York State sinking funds.

We did receive figures on New York State's Common Retirement Fund portfolio of investments as of March 31, 1975, when the total amounted to $6.269 billion, and the funds were held in prime investments. That was $709.2 million more than the total as of March 31, 1974.

We were informed by a witness that the pension and retirement funds of New York City amounted to $7.3 billion at book and were worth approximately $4.7 billion at market. Sinking funds for the City also apparently total another $750 million. A news article states that New York City contributes $1.2 billion a year to the City's pension and retirement funds. The estimate appears plausible since for the one fund for which we do have figures, namely the $2.492 billion, New York City Teachers' Retirement System, received $276 million in contributions from New York City in the fiscal year ended June 30, 1975.

Those are big numbers: Combined assets of $16.2 billion in the State and City retirement and pension systems and State and City contributions to those systems of approximately $2 billion a year.

We are aware of the New York State Court of Appeals decision that a trustee cannot be mandated to invest the funds under his control in Big Mac bonds. We are also aware of the law limiting the percentage of investment that may be invested in any one asset by a trustee. We likewise are aware of the Prudent Man Rule governing the proper investment conduct of trustees. And we are aware that short of bankruptcy, you cannot change the vested contract rights of beneficiaries of retirement and pension systems.

But strange things happen to established rules and laws when bankruptcy stares a State or municipality in the face if they do not make full use of billions of dollars of assets that have been and are being siphoned out of the State's and the City's income streams.

The Court decision referred to above does not preclude a trustee from investing in Big Mac bonds if he voluntarily chooses to do so. And the New York Legislature has passed a law on September 9, 1975, known as the New York State Financial Emergency Act for the City of New York, which eased the position of trustees voluntarily investing in Big Mac bonds. In effect, it repeals the applicability of the Prudent Man Rule to trustee investment in Big Mac bonds. The Act declares that Big Mac securities are prudent and legal investment for a trustee of a public pension or retirement system. It releases such trustee from culpability in the event they lose money on their Big Mac investments. Further, the Act makes Big Mac bonds acceptable security for certificates of deposit and an acceptable investment for City sinking funds.

In part, these $16.2 billion of State and City investment funds have been tapped in an important way for investment in Big Mac securities. As of October 20, 1975, New York City Pension Funds had invested $569.5 million in Big Mac bonds. In addition, New York City Sinking Funds had purchased $131.5 million of Big Mac bonds. At the State level, as of October 20, 1975, the New York State Insurance Fund had made purchases of $65 million of Big Mac securities and the New York State Pension Fund had bought $50 million of Big Mac bonds. These combined purchases total $842 million or about 5.2 percent of the combined City and State pension, retirement and sinking fund assets of $16.2 billion.

Since the State participation is comparatively meager, it would appear the State and Big Mac on September 15, 1975, engaged in a cosmetic operation to make the State's participation appear to be larger than it actually is. On that date, it would appear the State swapped $250 million of 1-year Revenue Anticipation notes for a like amount of Big Mac 1-year subordinated notes. At the end of the year, the swap will cancel. Meanwhile, the transaction will have padded the State's actual participation in Big Mac by $250 million.

Clearly without any more financial finagling than the State has already done in suspending the Prudent Man Rule with respect to Big Mac bonds, there is much more that could be done with the $16 billion of City and State fund assets. And not to be overlooked, of course, is that $2 billion per year of new funds, without any vested strings attached, that are diverted from the City and State's income streams and squirreled away in the supposedly safe haven of pension, retirement and sinking funds.

Years ago, when the present Mayor of New York City became the City's Comptroller, it was common knowledge in investment circles that practically all of the City's pension and retirement funds were invested in New York City obligations. The former Comptroller was credited with changing that established investment policy by disposing of the New York City obligations and replacing them with higher yielding other assets since the City derived no benefit from the tax exemption privilege accorded municipal debt. Perhaps it is time to again reverse that investment policy since the highest yielding investments around are Big Mac securities which most recently have been offered with 11 percent coupons.

New York politicians and bankers in recent weeks have pulled out all stops on rhetoric making default a horror word. That was not so back in February 1975, when *New York State did default* on a note issue of one of its "moral obligation" agencies, the Urban Development Corporation.

On February 25, the Urban Development Corporation failed to pay the principal of a $100 million note issue then due and failed to pay interest of approximately $5 million due on that date. It was default *by choice* on the part of New York State.

Financial markets did not collapse—as a matter of record, the Dow Jones Industrial Stock Average went up 90 points while the Urban Development Corporation was in default.

The default continued for approximately three months. On April 30th, the State voted approval of an aid package which removed restrictions on a previously authorized appropriation—not a new appropriation but a previous one—so that up to $110 million of that previously authorized appropriation could be used to cure the default.

Actually, the default was cured on May 20, 1975, from proceeds of a $140 million revolving credit established for the State's Project Finance Agency by the eleven New York Clearing House Banks. At that time, holders of the $100 million Urban Development Corporation notes were paid their principal in full, together with the $5.1 million of defaulted interest then due.

New York State credit was not destroyed by the default of its moral obligation agency. On May 28, 1975, New York State sold in the investment market $975 million of short-term tax anticipation notes at an average interest cost of 5.9976 percent. The notes dated June 16, 1975, were due $300 million on September 15, 1975, $300 million on December 30, 1975, and $375 million due on March 31, 1976.

Strange, isn't it, that when default actually occurred on a New York State agency issue last February there was hardly a ripple of rhetoric whereas now, when default has not occurred but might, the media has been saturated by the New York politicos and big bankers trying to sandbag the Congress for a guaranteed Federal bailout.

Title I, the New York City bailout provision in this legislation, should be stricken from the bill.

APPENDIX A

Bonded Debt of New York City as of June 30, 1975. Cash Receipts and Disbursements for Fiscal Years Ending June 30, 1975 and June 30, 1974 as Reported by the City Comptroller

NEW YORK (CITY OF)

	Outstanding—June 30, '75	Held by public
Bonded debt:[1]		
Redeemable from:		
Sinking tunds	$1, 249, 051, 550	$768, 124, 360
Taxation-serial	6, 335, 233, 580	6, 066, 671, 500
Assessments	1, 200, 000	1, 200, 000
Housing loans [3]	178, 270, 000	178, 270, 000
Urban renew. proj	2, 823, 040	[2] 2, 823, 040
Total funded	7, 766, 578, 170	7, 017, 088, 900
Bond antic. notes:		
Housing loans	1, 102, 175, 000	861, 675, 000
Mult. dwell. ins	118, 000, 000	87, 000, 000
Capital constr	350, 000, 000	150, 000, 000
Temporary debt notes:		
Tax antic	380, 000, 000	[4] 380, 000, 000
Rev. antic	2, 440, 000, 000	2, 440, 000, 000
Urban renewal	30, 000, 000	
Capital	120, 000, 000	120, 000, 000
Total temp. debt	4, 540, 175, 000	4, 038, 675, 000
Total bonded debt	12, 306, 753, 170	11, 055, 763, 900

[1] As reported by Comptroller.
[2] Issued to New York State.
[3] Serial bonds tor limited profit housing loans.
[4] Including $100,000,000 issued to the Munic. Assist. Corp.

Cash Receipts and Disbursement (excl. sink. funds & trust funds), years ended June 30 (on a warrant registered basis—as reported by City Comptroller) (in dollars):

	1975	1974
Receipts by general sources:		
Real estate taxes	$2, 657, 883, 314	$2, 495, 128, 667
Assessments	3, 028, 940	3, 787, 413
General fund:		
Sales tax	791, 103, 568	575, 386, 498
Personal income tax	559, 456, 664	538, 193, 415
General corporation tax	229, 288, 535	272, 933, 452
Unincorporated business income	43, 538, 073	37, 648, 879
Financial corporations	115, 602, 925	59, 684, 743
Insurance corporations	18, 281, 430	13, 324, 074
Transportation corporations	682, 586	673, 653
Commercial rents	191, 338, 999	177, 434, 193
Occupational-hotel room	8, 697, 776	9, 024, 245
Cigarette	30, 060, 739	30, 053, 747
Cigarette tar and nicotine	14, 913, 220	21, 067, 655
Utilities	90, 540, 713	70, 158, 632
Real property and fr	14, 310, 045	18, 436, 396
Commercial motor vehicle	5, 494, 439	5, 628, 739
Vault	3, 869, 739	4, 892, 704
Leaded gasoline	9, 694, 134	11, 663, 834
Other city taxes	869, 916	599, 452
Gasoline and motor vuel [1]	56, 483, 433	40, 576, 508
Mortgages [1]	20, 966, 886	27, 141, 789
Stock transfer [1]	184, 752, 328	189, 656, 637
Motor vehicle license fees [1]	5, 950, 192	6, 047, 568
Automobile use	16, 273, 078	
Off-track betting	67, 180, 065	44, 500, 000
State aid	413, 941, 825	369, 873, 398
Federal revenue sharing	256, 754, 060	262, 723, 562
Water charges	190, 757, 803	124, 842, 340
Fines and fees	91, 872, 477	82, 380, 854
Private rent, etc	980, 507, 802	384, 635, 109
Sewer rents	46, 688, 398	
Rev. ant. notes		648, 300, 000
Total general fund	[5] 4, 529, 876, 848	4, 027, 482, 076

See footnotes at end of table.

	1975	1974
Supplemental receipts:		
State aid	2, 458, 474, 341	1, 923, 075, 654
Federal aid	2, 010, 047, 935	1, 692, 268, 648
Others	93, 563, 878	89, 738, 622
Other receipts:		
State aid	748, 104, 310	193, 594, 587
Federal aid	465, 416, 569	337, 354, 966
Federal revenue sharing	67, 114, 874	4, 163, 980
Sewer rents	168, 622	43, 290, 986
Prop. sold, etc	21, 161, 392	13, 389, 306
Other receipts	dr76, 665, 705	dr9, 089, 027
Total receipts	12, 979, 148, 318	10, 814, 185, 878
Borrowings: [3]		
Tax ant. notes	1, 495, 000, 000	1, 067, 000, 000
Rev. ant. notes	4, 695, 000, 000	3, 825, 000, 000
Budget notes		308, 300, 000
Capital notes		5, 100, 000
Bond ant. notes	2, 068, 135, 000	1, 240, 945, 000
Urban ren. notes	137, 610, 000	171, 370, 000
Serial bonds	941, 920, 000	1, 486, 595, 000
Total borrowings	9, 337, 665, 000	8, 104, 310, 000
Total rec. and borr	22, 316, 813, 318	18, 918, 495, 878
Cash and inv., 7–1	d39, 345, 816	240, 224, 802
Total and bal	22, 277, 467, 502	19, 158, 720, 680
Disbursements by general functions:		
General government	333, 028, 605	341, 556, 372
Elem. high school education	2, 766, 299, 880	2, 501, 748, 410
College education	581, 757, 620	524, 108, 480
Parks, recr. and cult	206, 893, 973	213, 185, 368
Public safety:		
Police	853, 722, 034	776, 302, 251
Fire	371, 886, 064	355, 514, 889
Insp. & protect	5, 537, 244	4, 326, 826
Enviro. protect	745, 939, 164	674, 467, 771
Urban renew	69, 879, 028	62, 047, 725
Health serv	1, 030, 359, 151	920, 416, 789
Human resour	2, 902, 736, 926	2, 600, 956, 983
Econom. devel	91, 367, 220	119, 636, 583
Housing and devel	86, 456, 701	97, 143, 403
Munic. services	184, 340, 885	132, 593, 085
Transportation	182, 235, 723	160, 944, 645
Consumer affairs	12, 551, 438	15, 024, 427
Charit. inst. pay	558, 322, 835	488, 072, 492
Correction	115, 956, 445	101, 862, 966
Judicial	61, 623, 435	57, 031, 323
County exp.-gen	28, 680, 395	25, 597, 534
Co. exp. judicial	68, 341, 187	59, 266, 111
Transit	271, 448, 288	124, 614, 302
Water suppl. dev	58, 667, 312	49, 531, 804
Interest on debt	743, 917, 231	528, 938, 558
Misc.-Comptroller	1, 002, 521, 184	971, 819, 011
Other	47, 412, 714	17, 537, 466
[4] Hous. and dwell. In	261, 262, 407	192, 980, 878
[2] Total	13, 643, 145, 089	12, 117, 226, 452
[3] Debt redeemed	8, 098, 738, 620	7, 079, 846, 480
Debt amort	6, 138, 695	993, 564
Total disburse	21, 748, 022, 404	19, 198, 066, 496
Cash and inv., 6–30	529, 445, 098	d39, 345, 816

[1] State taxes.
[2] Includes bonded expenditures.
[3] Excl. $45,000,000 (1973, $47,000,000) rev. ant. notes issued to tax Appropriation & Gen. Fd. Stabilization Res. Fund which have been redeemed.
[4] Limited profit housing & multiple dwelling loans.
[5] Excl. $298,300,000 redemption of rev. antic. notes and refunds.

Source: May Report, p. 1,243.

Law Signed—Mayor Abraham Beame signed a bill allowing property owners to prepay real estate taxes at an 8% discount, a step ensuring that at least $150,000,000 from the prepayments would flow into the city's treasury by Sept. 13. The law signed by Mr. Beame actually allows property owners to prepay their taxes due between now and the end of the fiscal year. They are normally due in quarterly installments in Oct., Jan. and Apr. Those who agree to prepay their taxes receive an 8% discount on them, calculated on an annual basis.

ALBERT W. JOHNSON.
J. WILLIAM STANTON.
GARRY BROWN.
CHALMERS P. WYLIE.
JOHN H. ROUSSELOT.
JOHN B. CONLAN.
GEORGE HANSEN.
HENRY J. HYDE.
CHARLES E. GRASSLEY.

ADDITIONAL MINORITY VIEWS OF HON. JOHN B. CONLAN

During deliberations over this federal legislation to bail-out New York City, no real thought has been given to the further serious damage that such aid—whether direct or indirect—will inflict on the principle of federalism in American government.

Congress simply cannot, and will not, dispense aid to New York City without demanding strings on that aid. If Congress bails out New York City—which I firmly believe it should not do—responsibility on the part of Congress demands strict and specific controls on how that aid is used, and how New York puts its financial affairs in order.

This means that Congress will have to deal in detail with particular questions of a city's finances. This drainage of power to the government in Washington is one of the most worrisome aspects of this whole affair, with far greater long-run consequences for the Nation than a default. It is most important that New York City solve its own problems, that New York State solve its own problems, and that every level of government be immediately responsible to its own constituency for resolving whatever problems arise.

Otherwise, the unitary socialist state is brought just that much closer, with all its attendant loss of individual freedoms and creativity in meeting the needs and desires of the people in communities throughout America.

JOHN B. CONLAN.

DISSENTING VIEWS OF HON. CHARLES GRASSLEY

Should the American public be New York City's keeper? The city's current dilemma raises a number of serious questions which those who voted in favor of H.R. 10481 have refused to take account of. These include moral questions suggested by New York's inability to control its own finances as well as practical problems inherent in any Federal program designed to solve the financial difficulties of inferior political jurisdictions.

Members from both sides of the aisle have admitted that New York City has been poorly managed for at least the past decade. Below is a table prepared by the Library of Congress which puts in perspective just how reckless the city's spending has been. It should be made clear at this point, however, that any attempt to place the blame for New York's budgetary crisis on either one of the major parties is simply a smokescreen aimed at covering up the true nature of the problems involved.

TOTAL EXPENDITURES, INCREASE IN EXPENDITURES, GROSS DEBT OUTSTANDING, AND INCREASE IN GROSS DEBT IN NEW YORK CITY, FISCAL YEARS 1965–74

[In millions of dollars]

Year	Total expenditures	Increase in expenditures over previous year	Gross debt outstanding	Increase in gross debt over previous year
1974	12, 581	1, 045	13, 509	1, 745
1973	11, 536	824	11, 764	485
1972	10, 712	1, 180	11, 279	1, 114
1971	9, 532	1, 623	10, 165	1, 474
1970	7, 909	873	8, 691	688
1969	7, 036	1, 005	8, 003	86
1968	6, 031	889	7, 917	−2
1967	5, 142	577	7, 919	222
1966	4, 547	353	7, 697	238
1965	4, 194	227	7, 459	408

Source: U.S. Department of Commerce, Bureau of the Census. (Annual publication entitled "City Government Finances.")

Let's, then, analyze New York's situation in terms that I feel most members of the Committee will acknowledge as being valid. First, New York has clearly overspent and must either find new sources of revenue to decrease and eliminate its deficits and debt, or else reduce its spending. While the former, though politically distasteful, is a real alternative, and possible without any sort of Federal action, the latter is a wiser course of action. Certainly, it could involve personnel layoffs; but these could be minimized by a reduction in salaries and fringe benefits of those retained on the payroll, as well as more cost-effective management. For those who feel that such steps would be impossible or simply too painful, I invite you to review the case of Detroit in the early 1930's. At that time, the municipality faced a budget situation similar to New York's; but it overcame its dilemma

through the tough sorts of actions I listed above. Keep in mind, too, that there are currently Federal programs designed to help those who are severely affected by economic dislocation. This was not the case when Detroit made the tough decisions required to stave off financial disaster. Of course, many proponents of a Federal bond guarantee feel that such a program would be preferable to increased welfare or unemployment expenditures. I disagree. The sort of guarantee being promoted in H.R. 10481 fails to address itself to the fact that the leaders of New York have been less than straight-forward with the city's residents, that the municipality's accounting and financing procedures have been frought with irregularity, and that the policies of public officials have brought the city to the brink of financial chaos.

However powerful the New York labor unions may be, the actions of those elected officials who have refused to stand up and tell their constituents the truth—that New York could not go on indefinitely without making some sort of accommodation for its ever-burgeoning budget—are inexcusable. In essence, Congress, by aiding the city now, would be lending a degree of legitimacy to the city's leadership that these officials ought not to receive. Indeed, one reason the American people are overwhelmingly against a Federal bail-out of New York is that they are fed-up with dishonesty in politics, and the precedence short-term political considerations take over long-term, responsible planning. They are tired of paying bills created by politicians who appear more concerned with the next election than with the next generation. Events surrounding the last Administration in Washington created an air of cynicism among the populous which is only reinforced by the current situation in New York. Americans now feel that any public officials who act irresponsibly or dishonestly should pay a price, and should not be rescued by last minute emergency action which fails to strike at the root causes of the problem. I was particularly disturbed by a Wall Street Journal article of October 30 which details how Mayor Beame and New York State legislators tacitly participated in political chicanery seemingly intended, at least in part, to convince the American people that New York City's leaders were responsible enough to cope with its financial dilemma. Thousands of city employees were apparently laid off; but most were almost immediately rehired. In Mayor Beame's own words, "We all knew they would be put back * * * I think that, more than anything else, really hurt our credibility in the nation. * * *"

Now, many members of Congress fear that large-scale financial disruption would occur if New York defaulted. While Administration officials argue that long-term disruption is extremely unlikely, many are not convinced. Yet I believe we have more reason to fear the results of the bill discussed here than we do a New York default. In the first place, we have no idea what effect its passage would have on interest rates, and, thus, the current economic recovery. Investors, in anticipation of a New York default and a subsequent Federal pay-off of the defaulted obligations may rush out to borrow for fear that the Federal pay-off will raise interest rates later on. Or a guarantee, by inducing investors to put their money into New York city bonds, might cause borrowing rates for companies, states, and municipalities to rise because of a capital short-fall. Also, we have no assurance that those who could be affected by the actions of the Emergency Assistance Board—for example, pension recipients and current bondholders, might not bring suit against the Board, thus causing months or even years of inaction. Of course, the Board would, in any case be subject to the same sorts of political pressures that New York's public officials are currently subjected to. And I am also fearful that criticism of the Board's decisions might serve more as a camouflage to permit interference with the Federal Reserve's control over monetary policy than as a constructive means to improve the Board's handling of New York's dilemma.

Finally, I believe it is morally wrong to saddle future taxpayers in New York City, or any political jurisdiction, with debts incurred by today's leaders that promise no yields of fruit to future generations. Indeed, it is the taxdollars of these future taxpayers, many of whom have yet to be born, that would be used to pay off the long-term bonds which now help finance today's free university tuition, underutilized hospital rooms, over-generous fringe benefits for city employees, and the like.

In conclusion, New York should be allowed only to take advantage of altered bankruptcy laws. Control of the city's finances would be put in the hands of those who would have no reason to be anything but straightforward. In addition, such a course of action would make clear that the Federal government will not offer an umbrella to short-sighted politicians who insist on walking out naked into the rain.

CHARLES E. GRASSLEY.

DISSENTING VIEWS OF HON. WILLIS D. GRADISON, JR.

The proponents of a federal loan guarantee are claiming that the plan will not cost the American taxpayers a cent. In fact, they say, the loan guarantee plan will actually make money for the federal government.

In view of the fact that the federal deficit this year will be more than $70 billion, this logic is not surprising. Nevertheless, it should not go unchallenged.

In essence, the loan is an agreement by the federal government to borrow up to $7 billion for New York City. Congress would rather label federal debt as loan guarantees in the same way that New York City officials would rather call their debt Bond Anticipation Notes and Tax Anticipation Notes. This is understandable, but it should not blind us to the fact that federal loan guarantees will have the same effect on the market as federal borrowing. All Americans will pay for the loan guarantees through higher interest rates, more inflation, and less credit availability for private borrowers.

I am opposed in principle to forcing all Americans to pay for spending in New York City. If New York City residents want to continue to receive a higher level of social services than is the case elsewhere, there should be no objection. One of the great things about our federal system of government is that it allows for diversity at the local level. But fairness also demands that those who benefit from the services should pay for them.

In addition to my objection to the principle embodied in H.R. 10481, I am also opposed to several specific provisions of the bill.

(1) The amount of the loan guarantee is excessive. Governor Carey said in testimony before the Economic Stabilization Subcommittee, "* * * so that with a guarantee on bonds with a principal amount of five billion dollars we can effectively handle New York City's remaining short term debt." The Subcommittee received absolutely no testimony to support the higher $7 billion figure contained in H.R. 10481. The Senate Banking Committee apparently feels that $4 billion is sufficient. I strongly object to any loan guarantees whatsoever, but to give the city more than Governor Carey asked for would be ridiculous.

(2) There is no requirement that a guarantee fee be paid by New York City, although the Board *may* require one.

(3) There is no requirement that New York State extend any assistance to New York City, although the Board *may* require this.

(4) This bill would place control over the details of the city's finances in the hands of a five member board of federal officials, three of whom serve at the pleasure of the President. Not only will this mean decisions which should properly be made at the local level will be made at the federal level, but it will also mean that national political forces will impinge on essentially local issues.

(5) New York City officials have submitted a financial plan which supposedly will lead to a balanced budget in three years. There is no reason why a balanced budget should take three years to achieve when most cities, both large and small, balance their budgets every year. Furthermore, we are being asked to extend loan guarantees which may run until 1999. We have been given no assurance that New York City can live up to the three year plan, much less about what will happen after three years. In view of past performances, there is a good possibility the federal government will end up paying off the guaranteed loans.

The basic law of economics holds that there is no such thing as a free lunch. Having tried to exempt itself from this law, Congress is generously offering to repeal the law for New York City. The attempt will fail, of course, but if H.R. 10481 is enacted, the American people will pay dearly for the attempt.

WILLIS D. GRADISON, Jr.

DISSENTING VIEWS OF HON. RICHARD KELLY

As a witness to the carefully staged drama that has been played and replayed before this Congress in the last few weeks, I know every character and every line by heart. We have been told in our Committee meetings countless numbers of times that New York City and all of its inhabitants—particiularly the poor, the hungry, the unemployed (not to mention the banks)—are in grave danger should the City default. It has been carefully explained that default must be avoided at all costs for the sake of New York itself and all other municipalities across the country who are now or could ever be in financial trouble. It has been argued time and again that legislation such as the bill at hand must be enacted without delay based on the justifications that no one can help New York City now but the federal government (read: American taxpayer) and that a program of loan guarantees costs nothing.

My concern is that no one sees this drama for what it is—pure fiction. My concern is that it is too easy for many to believe the superficial story about the bill, rather than face the reality of what is happening. My concern is that Congress is treating this as just another item on the legislative schedule to be debated and passed without full cognizance of its true meaning for New York and of its long-range effect on the fabric of our national existence.

The Committee report will outline the mechanics of this "emergency assistance" program. The attention of the Congress and the public must be drawn to the real consequences:

1. *A complete surrender of control by New York City over its local affairs.*—The Intergovernmental Emergency Assistance Board is authorized to impose such terms and conditions as it deems appropriate with respect to making guarantees under the Act. Clearly, this is a violation of the separation of federal and local authorities since it was brought out in the Committee deliberations that federal control in New York City will be absolute following implementation of the "emergency" plan.

2. *The leadership of the municipal unions will be rewarded for extracting from the City more than it can afford to pay.*—Today the City of New York pays generally the highest municipal salaries in the United States and unparalleled pension benefits. In many instances, employee benefits were augmented when the City government was dealing from a position of vulnerability, when the people of New York were afraid of loosing important municipal services or of being exposed to hazards of their own health and safety. Because of the unusual powers of the City's union leaders, it has been easy for them to negotiate contracts that contain unjustifiable items, and by passage of this bill we reward them for their past successes and encourage similar activity by the growing numbers of municipal unions throughout the country.

3. *The poor are being used as tools.*—The poor, the sick, the hungry, the uneducated and the unemployed are ill-served by those who invoke their names in the campaign for a federal bail-out of the City. They are being used as an excuse to overlook the mismanagement and overspending that have characterized the City's government for so many years. It is of paramount importance to realize that those *who will be helped the most* by a bail-out are politicians and the bond-holders. The federal guarantees will increase the value of all paper issued by New York, to the disadvantage of all the cities and States across the country who will not have the opportunity of enjoying this display of largesse by the federal government.

4. *It weakens rather than strengthens New York's position.*—the rest of the country needs New York more than New York needs the rest of the country in this instance. If New York will help itself assume the responsibility for its own future, it will give inspiration to the rest of the country, raise itself in the eyes of the nation, and hopefully reverse the trend toward bankruptcy and fiscal irresponsibility for the whole country.

5. *It is a political solution to a financial problem.*— New York's problems are its own creation. No amount of rhetoric directed at the President of the United States or the Secretary of the Treasury can disguise the fact that budget decisions made by the City over the last 20 years have been the direct result of political and government choices made by the officials of the City and the direct cause of its current financial problems. By appealing to majority sentiment in Congress and attempting to shift the blame to the Executive branch, those who advocate this legislation are legitimizing the use of politics as a solution to what appears clearly to be plain and simple financial problems.

This legislation is an extension of the myth that there is something for nothing, and that what government does, does not have to be paid for. New York is looking at the stark reality of deficit spending. If a bail-out occurs, then reality will be avoided and the myth extended.

RICHARD KELLEY.

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94TH CONGRESS } HOUSE OF REPRESENTATIVES { REPORT
1st Session } { No. 94-632

INTERGOVERNMENTAL EMERGENCY ASSISTANCE ACT—PART II

NOVEMBER 13, 1975.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. ULLMAN, from the Committee on Ways and Means, submitted the following

REPORT

together with

SUPPLEMENTAL, MINORITY, AND DISSENTING VIEWS

[To accompany H.R. 10481]

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

The amendment is as follows:

Page 13, strike out lines 6 through 16, and insert in lieu thereof the following:

SEC. 201. TAXABILITY OF CERTAIN FEDERALLY GUARANTEED OBLIGATIONS.

(a) CERTAIN FEDERALLY GUARANTEED OBLIGATIONS.—Section 103 of the Internal Revenue Code of 1954 (relating to interest on certain governmental obligations) is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

"(e) CERTAIN FEDERALLY GUARANTEED OBLIGATIONS.—Any obligation—

"(1) which is issued after the date of the enactment of this subsection, and

"(2) the payment of interest or principal (or both) of which is, at the time of issuance, guaranteed in whole or in part under title I of the Intergovernmental Emergency Assistance Act (as in effect on the date of the enactment of this subsection),

shall be treated as an obligation not described in subsection (a)(1)."

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to taxable years ending after the date of the enactment of this Act.

I. Summary

The bill, H.R. 10481, as reported to the House by the Committee on Banking, Currency and Housing establishes a Federal agency that under certain conditions would be able to guarantee taxable debt issues of a city or municipality that faces default on its obligations or is in (or pending) bankruptcy. Since the bill requires that the interest on these obligations be subject to Federal income tax if the guarantees are to be effective, the bill, as reported, amends the Internal Revenue Code to provide that interest on these types of guaranteed obligations is to be taxable. In view of this amendment to the Internal Revenue Code, which is under the jurisdiction of the Committee on Ways and Means, the bill was sequentially referred to the committee on Ways and Means for consideration of title II of the bill which amends the tax laws.

Your committee did not consider the underlying legislation in title I of the bill. However, the committee did conclude that if Federal guarantees of State or local government obligations are to be provided, the interest on these obligations should be subject to Federal income tax. As a result, your committee's bill provides a substitute for title II of the bill which provides for taxation of interest on guaranteed obligations but only on those obligations issued after the date of enactment of the bill.

II. General Statement

Present law

Under present law (sec. 103 of the Internal Revenue Code) interest on most obligations issued by a State, a territory, a possession of the United States, the District of Columbia, or a political subdivision of any of the foregoing is excluded from gross income and is therefore exempt from taxation. This exclusion from gross income is not subject to waiver by the issuer of the obligations. Exceptions to this provision are provided for certain industrial development bonds and arbitrage bonds, the interest on which generally is taxable.

Obligations issued by the Federal Government, however, are generally subject to tax.

Reasons for change

On November 3, 1975, the Committee on Ways and Means was informed that pending legislation before the Committee on Banking, Currency and Housing to authorize emergency guarantees of obligations of States and their political subdivisions contained certain provisions which relate to the Ways and Means Committee's jurisdiction. When the bill, H.R. 10481, was reported to the House by the Committee on Banking, Currency and Housing on November 6, it was sequentially referred to the Committee on Ways and Means for consideration of Title II of the bill, which amended the Internal Revenue Code of 1954.

While the referral of H.R. 10481 to the Committee on Ways and Means involved only Title II, the committee's attention initially was drawn to section 111 of Title I, the Emergency Municipal Debt Guarantee Fund. This section provides for payments under the guarantee in the event the State or State agency issuing an obligation is not able to make a timely payment of interest or principal. The fund would

be financed by guarantee insurance fees, revenue sharing funds and the issue of Federal obligations under the Second Liberty Bond Act. The Committee on Ways and Means noted that this provision (sec. 111(c)), because of the reference to the Second Liberty Bond Act, is within its jurisdiction. Any issue of public debt obligations under this subsection also would affect the public debt limit. Probably more important, spending of Federal funds, whether derived from tax or debt receipts, would constitute spending of a kind that may be unlawful under the provisions of Title IV of the Congressional Budget and Impoundment Control Act of 1974. In response to these observations of the Ways and Means Committee and comments from other committees of the House, your committee understands that the Committee on Banking, Currency and Housing is to propose that section 111 be deleted from H.R. 10481.

The major focus of your committee's attention was on the provision under Title II of the bill dealing with the taxability of certain Federally guaranteed governmental obligations.

Because of its concern with the fiscal crisis in New York City, the Committee on Banking, Currency and Housing in the bill, H.R. 10481, which it reported to the House, establishes a Federal agency that under certain conditions would be able to guarantee taxable debt issues of a city or municipality that faces default on its obligations or is in (or pending) bankruptcy. Since the bill requires that the interest on these obligations be subject to Federal income tax if the Federal guarantees are to be effective, the bill, as reported, amended the Internal Revenue Code to provide that interest on these guaranteed obligations is to be taxable.

Your committee did not consider the provisions of title I of the bill which provide Federal assistance to distressed State or local governments, nor did it examine the obligation guarantee program provided in Title I. However, the committee did conclude that, if Federal guarantees of State or local government obligations are to be provided, the interest on these obligations should be subject to Federal income tax.

Your committee believes these bonds should be taxable for two reasons. First, Federal guarantees make these obligations more nearly comparable to obligations issued by the Federal Government, which are taxable. Allowing a tax exemption for the Federally guaranteed obligations would give them a competitive advantage in this respect over Federal obligations generally. Second, allowing a tax exemption for the interest on these obligations is an indirect form of assistance to the issuing government. Your committee concluded that any such assistance should be accomplished directly, rather than through the tax system, so that the amount of assistance to be given and the conditions governing the use of the assistance can be reviewed by the appropriate congressional committees through the authorization and annual appropriation process.

Explanation of provision

Your committee's bill provides a substitute for the provision in title II in the bill as referred to this committee. The committee substitute amends the Internal Revenue Code to provide that interest on obligations which are guaranteed under this bill are to be taxable. The substitute applies only to new issues and thus does not permit the taxation of any existing obligations. The amendment requires that the new issues be taxable if all or part of the interest or all or part of the principal (or all or part of both) is guaranteed. Any guarantee must be in effect at the time the obligation is issued. However, if the guarantee is later withdrawn from any obligation, the interest on that obligation remains taxable.

The substitute differs from the title referred to the committee in that the substitute provides for taxation or interest only from such guaranteed securities issued after the date of enactment of the bill. The substitute further provides that the taxable status of the bonds is to apply only if no amendments are made after enactment to Title I (the title providing the guarantees). As a result, if any amendments to Title I are made, amendments to Title II would be required before additional taxable obligations are issued (a requirement for the bonds to be eligible for the guarantees). In this way, the tax-writing committees of Congress will have an opportunity to review any future amendments to the legislation affecting the tax treatment of any new obligations.

III. Effect on the Revenues of the Bill and Vote of the Committee in Reporting the Bill

In compliance with clause 7 of rule XIII of the Rules of the House of Representatives, the following statement is made relative to the effect on the revenues of this bill.

It is estimated that over the period 1976–1981, total additional income taxes of $326.5 million will be collected as a result of this bill. Also, it is estimated over the same period that total guarantee fees of $162.5 million will be collected. Thus, total additional revenues are estimated at $489 million in the period from 1976 to 1981. These estimates are predicated on levels of average outstanding obligations displayed in Table 1. Also, it is assumed that no default will occur on the obligations guaranteed. If the entire guarantee authority is utilized and if the entire issue defaulted, the cost of the guarantee could be as much as $7 billion. On the basis of experience in comparable loan guarantee programs, it is estimated that annual administrative expenses will be less than $1 million.

TABLE 1[1]

[In millions of dollars]

Fiscal year	Approximate average outstanding guaranteed obligations	Income taxes	Guarantee fees
1976	1,400	21.0	10.5
1977	3,350	50.0	25.0
1978	4,100	61.5	31.0
1979	4,400	66.0	33.0
1980	4,325	65.0	32.0
1981	4,175	63.0	31.0
Total	NA	326.5	162.5

[1] Assumes 7.5 percent yield.

In compliance with clause 2(l)(2)(B) of Rule XI of the Rules of the House of Representatives, the following statement is made relative to the record vote by the committee on the motion to report the bill. The bill was ordered reported by a roll call vote of 20 in favor and 13 opposed.

IV. Other Matters Required To Be Discussed Under House Rules

In compliance with clauses 2(l)(3) and 2(l)(4) of Rule XI of the Rules of the House of Representatives, the following statements are made.

With respect to subdivision (A) of clauses 3 relating to oversight findings, your committee advises that in its review of the tax treatment of obligations of States and their municipalities, it concluded that the changes in taxation in Title II of the bill should be made with respect to the taxable status of such obligations which are guaranteed by the Federal Government in order to provide consistent treatment of such obligations with Federal obligations generally. This is also desirable in order to distinguish them from other State and municipal obligations which are not guaranteed.

In compliance with subdivision (B) of clause 3 of Rule XI of the Rules of the House of Representatives, the committee states that the changes made to this bill involve no new budget authority.

With respect to subdivisions (C) and (D) of clause 3 of Rule XI of the Rules of the House of Representatives, your committee advises that no estimate of comparison has been submitted to your committee by the Director of the Congressional Budget Office relative to the changes made by your committee, nor have any oversight findings or recommendations ben submitted to your committee by the Committee on Government Operations.

In compliance with clause 2(l)(4) of Rule XI of the Rules of the House of Representatives, your committee states that the inflation impact of the changes made to this bill should be negligible.

V. Changes in Existing Law Made by the Bill, as Reported

In compliance with clause 3 of Rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

SECTION 103 OF THE INTERNAL REVENUE CODE OF 1954

Sec. 103. Interest on Certain Governmental Obligations

(a) General Rule.—Gross income does not include interest on—

(1) the obligations of a State, a Territory, or a possession of the United States, or any political subdivision of any of the foregoing, or the District of Columbia;

(2) the obligations of the United States; or

(3) the obligations of a corporation organized under Act of Congress, if such corporation is an instrumentality of the United

States and if under the respective Acts authorizing the issue of the obligations the interest is wholly exempt from the taxes imposed by this subtitle.

(b) EXCEPTION.—Subsection (a)(2) shall not apply to interest on obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit, to the extent they represent deposits made before March 1, 1941), unless the respective Acts authorizing the issuance thereof such interest is wholly exempt from the taxes imposed by this subtitle.

(c) INDUSTRIAL DEVELOPMENT BONDS.—

(1) SUBSECTION (a)(1) NOT TO APPLY.—Except as otherwise provided in this subsection, any industrial development bond shall be treated as an obligation not described in subsection (a)(1).

(2) INDUSTRIAL DEVELOPMENT BOND.—For purposes of this subsection, the term "industrial development bond" means any obligation—

(A) which is issued as part of an issue all or a major portion of the proceeds of which are to be used directly or indirectly in any trade or business carried on by any person who is not an exempt person (within the meaning of paragraph (3)), and

(B) the payment of the principal or interest on which (under the terms of such obligation or any underlying arrangement) is, in whole or in major part—

(i) secured by any interest in property used or to be used in a trade or business or in payments in respect of such property, or

(ii) to be derived from payments in respect of property, or borrowed money, used or to be used in a trade or business.

(3) EXEMPT PERSON.—For purposes of paragraph (2)(A), the term "exempt person" means—

(A) a governmental unit, or

(B) an organization described in section 501(c)(3) and exempt from tax under section 501(a) (but only with respect to a trade or business carried on by such organization which is not an unrelated trade or business, determined by applying section 513(a) to such organization).

(4) CERTAIN EXEMPT ACTIVITIES.—Paragraph (1) shall not apply to any obligation which is issued as part of an issue substantially all of the proceeds of which are to be used to provide—

(A) residential real property for family units,

(B) sports facilities,

(C) convention or trade show facilities,

(D) airports, docks, wharves, mass commuting facilities, parking facilities, or storage or training facilities directly related to any of the foregoing,

(E) sewage or solid waste disposal facilities or facilities for the local furnishing of electric energy or gas,

(F) air or water pollution control facilities, or

(G) facilities for the furnishing of water, if available on reasonable demand to members of the general public.

(5) INDUSRIAL PARKS.—Paragraph (1) shall not apply to any obligation issued as part of an issue substantially all of the proceeds of which are to be used for the acquisition or development of land as the site for an industrial park. For purposes of the preceding sentence, the term "development of land" includes the provision of water, sewage, drainage, or similar facilities, or of transportation, power, or communication facilities, which are incidental to use of the site as an industrial park, but, except with respect to such facilities, does not include the provision of structures or buildings.

(6) EXEMPTION FOR CERTAIN SMALL ISSUES.—

(A) IN GENERAL.—Paragraph (1) shall not apply to any obligation issued as part of an issue the aggregate authorized face amount of which is $1,000,000 or less and substantially all of the proceeds of which are to be used (i) for the acquisition, construction, reconstruction, or improvement of land or property of a character subject to the allowance for depreciation, or (ii) to redeem part or all of a prior issue which was issued for purposes described in clause (i) or this clause.

(B) CERTAIN PRIOR ISSUES TAKEN INTO ACCOUNT.—If—

(i) the proceeds of two or more issues of obligations (whether or not the issuer of each such issue is the same) are or will be used primarily with respect to facilities located in the same incorporated municipality or located in the same county (but not in any incorporated municipality),

(ii) the principal user of such facilities is or will be the same person or two or more related persons, and

(iii) but for this subparagraph, subparagraph (A) would apply to each such issue,

then, for purposes of subparagraph (A), in determining the aggregate face amount of any later issue there shall be taken into account the face amount of obligations issued under all prior such issues and outstanding at the time of such later issue (not including outstanding any obligation which is to be redeemed through the proceeds of the later issue).

(C) RELATED PERSONS.—For purposes of this paragraph and paragraph (7), a person is a related person to another person if—

(i) the relationship between such persons would result in a disallowance of losses under section 267 or 707(b), or

(ii) such persons are members of the same controlled group of corporations (as defined in section 1563(a), except that "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears therein).

(D) $5,000,000 LIMIT IN CERTAIN CASES.—At the election of the issuer, made at such time and in such manner as the Secretary or his delegate shall by regulations prescribe, with respect to any issue this paragraph shall be applied—

(i) substituting "$5,000,000" for "$1,000,000" in subparagraph (A), and

(ii) in determining the aggregate face amount of such issue, by taking into account not only the amount described in subparagraph (B), but also the aggregate amount of capital expenditures with respect to facilities described in subparagraph (E) paid or incurred during the 6-year period beginning 3 years before the date of such issue and ending 3 years after such date (and financed otherwise than out of the proceeds of outstanding issues to which subparagraph (A) applied), as if the aggregate amount of such capital expenditures constituted the face amount of a prior outstanding issue described in subparagraph (B).

(E) FACILITIES TAKEN INTO ACCOUNT.—For purposes of subparagraph (D)(ii), the facilities described in this subparagraph are facilities—

(i) located in the same incorporated municipality or located in the same county (but not in any incorporated municipality), and

(ii) the principal user of which is or will be the same person or two or more related persons.

For purposes of clause (i), the determination of whether or not facilities are located in the same governmental unit shall be made as of the date of issue of the issue in question.

(F) CERTAIN CAPITAL EXPENDITURES NOT TAKEN INTO ACCOUNT.—For purposes of subparagraph (D)(ii), any capital expenditure—

(i) to replace property destroyed or damaged by fire, storm, or other casualty, to the extent of the fair market value of the property replaced,

(ii) required by a change made after the date of issue of the issue in question in a Federal or State law or local ordinance of general application or required by a change made after such date in rules and regulations of general application issued under such a law or ordinance, or

(iii) required by circumstances which could not be reasonably foreseen on such date of issue or arising out of a mistake of law or fact (but the aggregate amount of expenditures not taken into account under this clause with respect to any issue shall not exceed $1,000,000),

shall not be taken into account.

(G) LIMITATION ON LOSS OF TAX EXEMPTION.—In applying subparagraph (D)(ii) with respect to capital expenditures made after the date of any issue, no obligation issued as a part of such issue shall be treated as an obligation not described in subsection (a)(1) by reason of any such expenditure for any period before the date on which such expenditure is paid or incurred.

(H) CERTAIN REFINANCING ISSUES.— In the case of any issue described in subparagraph (A)(ii), an election may be made under subparagraph (D) only if all of the prior issues being redeemed are issues to which subparagraph (A) applies. In applying subparagraph (D)(ii) with respect to such

a refinancing issue, capital expenditures shall be taken into account only for purposes of determining whether the prior issues being redeemed qualified (and would have continued to qualify) under subparagraph (A).

(7) EXCEPTION.—Paragraphs (4), (5), and (6) shall not apply with respect to any obligation for any period during which it is held by a person who is a substantial user of the facilities or a related person.

(d) ARBITRAGE BONDS.—

(1) SUBSECTION (a)(1) NOT TO APPLY.—Except as provided in this subsection, any arbritage bond shall be treated as an obligation not described in subsection (a)(1).

(2) ARBITRAGE BOND.—For purposes of this subsection, the term "arbitrage bond" means any obligation which is issued as part of an issue all or a major portion of the proceeds of which are reasonably expected to be used directly or indirectly—

(A) to acquire securities (within the meaning of section 165(g)(2)(A) or (B)) or obligations other than obligations described in subsection (a)(1)) which may be reasonably expected at the time of issuance of such issue, to produce a yield over the term of the issue which is materially higher taking into account any discount or premium) than the yield on obligations of such issue, or

(B) to replace funds which were used directly or indirectly to acquire securities or obligations described in subparagraph (A).

(3) EXCEPTION.—Paragraph (1) shall not apply to any obligation—

(A) which is issued as part of an issue substantially all of the proceeds of which are reasonably expected to be used to provide permanent financing for real property used or to be used for residential purposes for the personnel of an educational institution (within the meaning of section 151(e)(4)) which grants baccalaureate or higher degrees, or to replace funds which were so used, and

(B) the yield on which over the term of the issue is not reasonably expected, at the time of issuance of such issue, to be substantially lower than the yield on obligations acquired or to be acquired in providing such financing.

This paragraph shall not apply with respect to any obligation for any period during which it is held by a person who is a substantial user of property financed by the proceeds of the issue of which such obligation is a part, or by a member of the family (within the meaning of section 318(a)(1)) of any such person.

(4) SPECIAL RULES.—For purposes of paragraph (1), an obligation shall not be treated as an arbitrage bond solely by reason of the fact that—

(A) the proceeds of the issue of which such obligation is a part may be invested for a temporary period in securities or other obligations until such proceeds are needed for the purpose for which such issue was issued, or

(B) an amount of the proceeds of the issue of which such obligation is a part may be invested in securities or other obligations which are part of a reasonably required reserve or replacement fund.

The amount referred to in subparagraph (B) shall not exceed 15 percent of the proceeds of the issue of which such obligation is a part unless the issuer establishes that a higher amount is necessary.

(5) REGULATIONS.—The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this subsection.

(e) CERTAIN FEDERALLY GUARANTEED OBLIGATIONS.—Any obligation—

(1) which is issued after the date of the enactment of this subsection, and

(2) the payment of interest or principal (or both) of which is, at the time of issuance, guaranteed in whole or in part under title I of the Intergovernmental Emergency Assistance Act (as in effect on the date of the enactment of this subsection), shall be treated as an obligation not described in subsection (a)(1).

[(e)] *(f)* CROSS REFERENCES.—

For provisions relating to the taxable status of—

(1) Bonds and certificates of indebtedness authorized by the First Liberty Bond Act, see sections 1 and 6 of that Act (40 Stat. 35, 36; 31 U. S. C. 746, 755);

(2) Bonds issued to restore or maintain the gold reserve, see section 2 of the Act of March 14, 1900 (31 Stat. 46; 31 U. S. C. 408);

(3) Bonds, notes, certificates of indebtedness, and Treasury bills authorized by the Second Liberty Bond Act, see sections 4, 5 (b) and (d), 7, 18 (b), and 22 (d) of that Act, as amended (40 Stat. 290; 46 Stat. 20, 775; 40 Stat. 291, 1310; 55 Stat. 8; 31 U.S.C. 752a, 754, 747, 753, 757c);

(4) Bonds, notes, and certificates of indebtedness of the United States and bonds of the War Finance Corporation owned by certain nonresidents, see section 3 of the Fourth Liberty Bond Act, as amended (40 Stat. 1311, § 4; 31 U. S. C. 750);

(5) Certificates of indebtedness issued after February 4, 1910, see section 2 of the Act of that date (36 Stat. 192; 31 U. S. C. 769);

(6) Consols of 1930, see section 11 of the Act of March 14, 1900 (31 Stat. 48; 31 U. S. C. 751);

(7) Obligations and evidences of ownership issued by the United States or any of its agencies or instrumentalities on or after March 28, 1942, see section 4 of the Public Debt Act of 1941, as amended (c. 147, 61 Stat. 180; 31 U. S. C. 742a);

(8) Commodity Credit Corporation obligations, see section 5 of the Act of March 8, 1938 (52 Stat. 108; 15 U. S. C. 713a-5);

(9) Debentures issued by Federal Housing Administrator, see sections 204 (d) and 207 (i) of the National Housing Act, as amended (52 Stat. 14, 20; 12 U.S.C. 1710, 1713);

(10) Debentures issued to mortgages by United States Maritime Commission, see section 1105 (c) of the Merchant Marine Act, 1936, as amended (52 Stat. 972; 46 U.S.C. 1275);

(11) Federal Deposit Insurance Corporation obligations, see section 15 of the Federal Deposit Insurance Act (64 Stat. 890; 12 U. S. C. 1825);

(12) Federal Home Loan Bank obligations, see section 13 of the Federal Home Loan Bank Act, as amended (49 Stat. 295, § 8; 12 U. S. C. 1433);

(13) Federal savings and loan association loans, see section 5 (h) of the Home Owners' Loan Act of 1933, as amended (48 Stat. 133; 12 U. S. C. 1464);

(14) Federal Savings and Loan Insurance Corporation obligations, see section 402(e) of the National Housing Act (48 Stat. 1257; 12 U. S. C. 1725);

(15) Home Owners' Loan Corporation bonds, see section 4 (c) of the Home Owners' Loan Act of 1933, as amended (48 Stat. 644, c. 168; 12 U. S. C. 1463);

(16) Obligations of Central Bank for Cooperatives, production credit corporations, production credit associations, and banks for cooperatives, see section 63 of the Farm Credit Act of 1933 (48 Stat. 267; 12 U.S.C. 1138c);

(17) Panama Canal bonds, see section 1 of the Act of December 21, 1904 (34 Stat. 5; 31 U. S. C. 743), section 8 of the Act of June 28, 1902 (32 Stat. 484; 31 U. S. C. 744), and section 39 of the Tariff Act of 1909 (36 Stat. 117; 31 U. S. C. 745);

(18) Philippine bonds, etc., issued before the independence of the Philippines, see section 9 of the Philippine Independence Act (48 Stat. 463; 48 U. S. C. 1239);

(19) Postal savings bonds, see section 10 of the Act of June 25, 1910 (36 Stat. 817; 39 U. S. C. 760);

(20) Puerto Rican bonds, see section 3 of the Act of March 2, 1917, as amended (50 Stat. 844; 48 U. S. C. 745);

(21) Treasury notes issued to retire national bank notes, see section 18 of the Federal Reserve Act (38 Stat. 268; 12 U. S. C. 447);

(22) United States Housing Authority obligations, see sections 5 (e) and 20 (b) of the United States Housing Act of 1937 (50 Stat. 890, 898, 42 U. S. C. 1405, 1420);

(23) Virgin Islands insular and municipal bonds, see section 1 of the Act of October 27, 1949 (63 Stat. 940; 48 U. S. C. 1403).

NOVEMBER 12, 1975.

VI. DISSENTING VIEWS OF HON. HAROLD FORD

I have opposed the provision of taxable guaranteed bonds for fiscally distressed municipalities, not because I am without concern about the financial difficulties some are facing, but because I think it is inappropriate for the Federal Government to step in to provide financial assistance. It is a new kind of Federalism which I fear the Committee does not fully appreciate, but will learn to regret.

The provision of such guarantees has been prompted by New York City's fiscal problems. The question before the Committee is whether the Congress should provide financial assistance before the City and the State of New York have exhausted their resources to raise revenues and examined every item in the City's budget to achieve economies. By providing guarantees to financially distressed municipalities, we are in effect relieving the State governments of their constitutional responsibilities to their localities. Moreover, we are enabling the city to forestall hard decisions about spending and taxing which their elected officials have been placed in office to make. I see no merit in having the Congress catch the fiscal hot potato and foot the bill. It would serve to establish a dangerous precedent, encouraging mischievous claims on Federal tax dollars by incompetent State and local Administrations.

Over the years, the Congress has properly addressed particular social problems which cities face and provided targeted assistance. This is appropriate and I support such measures. However, what this bill does is provide aid for a new kind of social problem: fiscal irresponsibility and mismanagement on the part of locally elected officials, and I fear the cure of Federal assistance may induce other cities and their officials to catch the disease.

Let us be clear. There are a wide variety of areas in New York where substantial cuts can be achieved now. Currently, better than 25 percent of the City supported hospital beds are vacant. The City heavily subsidizes the City University system at a level well beyond that of any other public university. The pay scales in New York far exceed those in other cities in the Nation: a sanitation worker with three-years' experience now receives a base salary of nearly $15,000 per year. After one year of service, City employees get four-week vacations with pay and unlimited sick leave. I find it hard to believe in view of these facts that New York City has exhausted its search for economies in government. Supporting a guarantee at this point amounts to supporting this kind of municipal largesse. I cannot support taxing my constituents to pay these kinds of wages and benefit levels in New York City. It is about time the citizens and employees of the City face up to the fact that they have chosen to provide services and wages well beyond their means. I seriously doubt that my colleagues on this great committee have intended to relieve the citizens of New York from the responsibilities they have created over the past years by voting for politicians who promised more service without the necessary financing.

The solution to the fiscal problems of New York lies with the City and the State. City employees must become realistic about wages, benefits, and their pension rights, and citizens must become realistic about the level of services they can obtain for their tax dollar. The elected officials in the City and the State have to become more realistic about what they can promise within the tax resources they wish to impose. When the elected officials, City employees, and Citizens of New York begin to act like their counterparts across the country, revenues will equal expenditures, and the fiscal problems of the City will disappear.

HAROLD FORD.

VII. MINORITY VIEWS

The Intergovernmental Emergency Assistance Act was favorably reported by the House Committee on Banking, Currency and Housing and referred to the Committee on Ways and Means for its review of Title II. This title would amend the Internal Revenue Code of 1954 to make taxable the interest earned on obligations subject to Federal guarantees under other provisions of the Bill. Since only Title II of the Bill was referred to the Committee on Ways and Means, we did not directly consider or deal with the provisions of the Bill contained in Title I.

Interest on State and municipal obligations is now excluded from gross income for tax purposes under Section 103(a)(1) of the Internal Revenue Code. Title II would alter that to make taxable the interest on bonds which are Federally guaranteed. This would avoid the obvious inequity of providing some investors both a guarantee and preferential tax treatment.

Our favorable votes on Title II do not constitute an acceptance of the argument that New York City should be provided Federal loan guarantees. We believe, and our votes reflect our belief, that if Federal loan guarantees ultimately are provided, the interest on the obligations involved should be taxable.

Absent the change in the Internal Revenue Code which is embodied in Title II, this Bill might well create a class of investments so attractive as to constitute a clear threat to other States and their subdivisions in the bond market. Investors would be inclined to choose Federally guaranteed tax-exempt New York obligations over those issued by fiscally responsible jurisdictions but not Federally guaranteed. With their combined Federal guarantee and tax preference the New York bonds would simply be too attractive, and others desiring to sell their bonds would find it difficult to compete.

We voted for Title II for only these reasons and reserve the right to vote against the other portions of the Bill on the House Floor.

H. T. SCHNEEBELI.
BARBER B. CONABLE, Jr.
W. A. STEIGER.
BILL FRENZEL.
JIM MARTIN.

VIII. DISSENTING VIEWS OF THE HON. PHILIP M. CRANE

I am totally opposed to a Federal bail out of New York City. For years that City has been operated on an unacceptable fiscal basis; to reward such inherently unwise and unsound governmental policy and actions with a Federal bail out would be reprehensible.

There simply is no earthly reason why the taxpayers of Illinois or California or any other State should be forced to pay for the extravagant nature of those officials in New York who have sought reelection year after year on outrageously underfinanced budgets. They have borrowed and borrowed for today not planning adequately to pay tomorrow; but tomorrow has come.

PHILIP M. CRANE.

IX. SUPPLEMENTAL VIEWS OF HON. BILL FRENZEL

I voted in favor of Title II of HR 10481 which passed the Ways and Means Committee after sequential reference from the Banking and Currency Committee.

My affirmative vote was simply to ensure that any bonds which may be guaranteed by the Federal Government will not also be tax exempt. My vote on Title II in no way represents an endorsement of HR 10481.

The concept of sequential reference worked well in the case of HR 10481. The Ways and Means Committee was able to get the Banking and Currencey Committee's agreement to remove the back door spending provisions of Section 111 of Title I and to clarify the language of Section 103. In addition, Title II was completely rewritten to ensure that prior obligations would not be guaranteed.

I believe it is important to protect the principle of sequential reference, and therefore I voted in favor of what the Ways and Means Committee accomplished on this bill. Still, it is my present intention to vote agianst HR 10481.

BILL FRENZEL.

X. DISSENTING VIEWS OF HON. DONALD D. CLANCY AND HON. WILLIAM M. KETCHUM

While I strenuously oppose Title I of this bill, I recognize that it is properly under the jurisdiction of the Committee on Banking, Currency and Housing. I shall simply state that I object to the concept that the American taxpayer should pay for the municipal extravaganza that has been held in New York for decades.

There is nothing particularly obtuse about Title II. It simply states that the municipal bonds guaranteed under Title I are subject to taxation by the Federal government. This is a precedent which is as potentially harmful as that set out in the bail-out provision of Title I, and is the first step towards elimination of the exemption for local government bonds.

The majority of people who purchase state and municipal bonds do not do so out of an overwhelming sense of civic pride. The attractiveness of these issues consists of their high yield and their tax exempt status. For some time, advocates of "tax reform" have spoken of their desire to see the latter "shelter" removed. Title II of this bill will give this movement a powerful impetus.

I am convinced that should this occur the effect on local governments' financing would be disastrous. Bond issues would go begging for purchasers. The spector of default would loom over hundreds of our cities, and scores of states. And the guarantee provisions of Title I would be brought into play, with the Federal government finally bailing out everyone.

I have sympathy for the people of New York. But that sympathy does not extend to supporting legislation whose precedents I fear will visit New York's plight upon countless other towns. State and local bonds have been free from taxation almost as long as they have been in existence. Tinkering with that fine system is ruinous fiscal policy. This bill should be defeated.

WILLIAM M. KETCHUM.
DONALD D. CLANCY.

O

94TH CONGRESS } HOUSE OF REPRESENTATIVES { REPORT
1st Session } { No. 94–665

CONSIDERATION OF H.R. 10481

NOVEMBER 14, 1975.—Referred to the House Calendar and ordered to be printed

Mr. DELANEY, from the Committee on Rules
submitted the following

REPORT

[To accompany H. Res. 865]

The Committee on Rules, having had under consideration House Resolution 865, by a nonrecord vote, report the same to the House with the recommendation that the resolution do pass.

O

57–008

Calendar No. 429

94TH CONGRESS 1st Session | SENATE | REPORT No. 94–443

VOLUNTARY MUNICIPAL REORGANIZATION ACT OF 1975

REPORT

OF THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS UNITED STATES SENATE

TO ACCOMPANY

S. 2615

TOGETHER WITH MINORITY AND ADDITIONAL VIEWS

NOVEMBER 4, 1975.—Ordered to be printed

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COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

CONTENTS

I. History of the Legislation

The Committee on Banking, Housing and Urban Affairs held hearings on October 9, 10 and 18 on 1862, S. 2372, S. 1833, and other proposals to provide loan guarantees or other financial assistance to local governments.

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

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

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

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

II. Summary of the Legislation

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

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

The main provisions of the legislation are as follows:

1. Authorizes $4 billion in Federal guarantees of new State securities in order to prevent a New York City default. The securities guaran-

teed would be limited to a one-year maturity. The guarantee authority would be phased out over a four-year period so that the maximum amount outstanding would be $4 billion through June 30, 1977; $3.5 billion through June 30, 1978; $2.5 billion through June 30, 1979; $1.5 billion through June 30, 1980; and zero thereafter.

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

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

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

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

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

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

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

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

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

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

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

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

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

III. Need for the Legislation

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

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

New York State has severely strained its own resources to shore up the City, and their fates are now closely linked. The State's credit rating dropped, and there is every indication that the market is closing to the State and its agencies. The Housing Finance Agency faces default in mid-November because it cannot borrow to cover $100 million in notes coming due. If the City defaults, there is little likelihood that the State agencies will be able to borrow the $2 billion they will need by the end of the fiscal year. New York State itself has no major borrowing needs at this time, apart from $150 million to complete the package to help the City through to December. In the spring, however, it will have to borrow $3.5 million in tax anticipation notes in order to make State aid payments to its municipalities. If it cannot market those notes, it will not meet those payments, and the loss of State assistance payments could trigger a wave of municipal defaults throughout the State. Already cities such as Yonkers are finding it hard to market their bonds, due to the contagion of the New York City crisis.

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

The immediate consequences of default would be disastrous for New York City. Even if it made no debt service payments, the City would still be short about $1.2 billion for the period from December through March, due to seasonal shortfalls in revenues as well as the overall budget deficit. This represents about one-half of the controllable items in the City's budget. It would mean payrolls unmet and massive layoffs of city workers, school closings, no pay-outs for supplies to hospital and prisons, vendors to the City driven into bankruptcy, abandoned construction sites.

Default is likely to cripple the City and halt its progress toward fiscal stability. First, it will mean a sharp decline in tax revenues. If the City fails to pay debt service, it could lose the 43 percent of its real estate taxes earmarked for this purpose. Tax delinquencies could skim off $400 million at least. Income and sales tax collections will drop due to loss of jobs and businesses. An expected advance of $800 million from the State probably would not be paid. Legal problems could block Federal and State welfare and Medicaid payments, if the City cannot meet its matching contributions. All told, the City's cash deficit through June 20 could exceed $2 billion.

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

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

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

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

The banking system will be jolted by a default of New York City, and still more so if the State defaults as well. An estimate of the number of bank failures which could occur, according to testimony given by the three bank regulatory agencies, includes 22 national banks, 30 nonmember banks, and 17 State member banks. A far larger number would find their capital seriously impaired. The banks in danger of failing are predominantly smaller institutions scattered throughout the country; only a few are in New York State. The agencies supplied a list of the States affected but would not reveal the names of the individual banks, for fear of touching off runs on those banks. Although it appears that the banking system as a whole could

absorb the impact of default without major disruption, the effect could be devastating on a number of towns and cities throughout the country.

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

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

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

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

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

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

The Government will not lose money under the Committee's bill. On the contrary, it will make money. The guarantee would be secured against any losses by the State and City's revenue sharing entitlements (about $500 million a year) and by a first lien on the City's tax revenues. Furthermore, the guarantee fee charged will earn money for the Federal government. If it remains at 3½ on tax-exempt securities, then the Government will take in over $400 million in revenues over the life of the guarantee. If the securities are made taxable and the guarantee fee drops to 1 percent, which is preferable from the standpoint of the bond market, then the government will still gain over $100 million plus an equivalent amount of additional tax revenues.

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

IV. Background of the New York City Fiscal Crisis

A. Causes of the Crisis

Immediate Causes

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

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

Most cities issue some short-term notes, to tide them over until anticipated revenues come in or to fund capital construction when long-term interest rates are too high. New York City, however, now relies far more heavily on short-term borrowing than other cities. The city has consistently run a deficit in its operating budget in recent years, and it has borrowed short-term to fund that deficit. As a result, it must roll-over $2.6 billion short term debt between December 1, 1975 and June 30, 1976. In addition, during this same period, the city faces a deficit of about $500 million on current account and $1 billion to finance the capital program. If New York City cannot borrow to cover these needs, it will have to default on its obligations as they come due. Given that the credit markets are no longer open to the City on any terms, and that alternative sources of funding are drying up, default is likely in the absence of any Federal assistance.

Roots of the Crisis

There is no doubt that many of New York City's problems are largely of its own making—the result of bad management and fiscal legerdemain, carried on over the years by numerous public officials.

Under State law, the City has to balance its budget, and the State has to certify that the City has done so. In fact, the City was running up an ever-increasing deficit, and State and City officials came up with various fiscal gimmicks to get around the balanced budget requirement. Deficits were funded by short-term borrowing in anticipation of revenues that would never materialize. Operating expenses were piled into the capital budget and funded through long-term borrowing. All this just postponed the day of reckoning.

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

Another factor which has received widespread attention is the large growth in the number of New York City employees, and in the pay which they receive. The City now has 528.2 employees for every 10,000 residents, far more than any other city in the country except Washington, D.C. Its employees are also some of the highest paid. Their pension benefits are indisputably higher, with virtually no employee contributions required, and no one can claim that pension liabilities are adequately funded in the City's present budget.

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

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

While the City's population has remained stable in numbers, it has grown poorer. The last 25 years have seen the flight of the affluent middle class to the suburbs and a large in-migration from the South and Puerto Rico. According to a study by the Joint Economic Committee, the size of New York's poverty population has changed drastically since 1960—from one of the lowest in the country to the second highest. Out of 7.6 million residents, about one million are on welfare. Not only does New York City have the largest welfare population in the country, in absolute terms, but it also bears the largest welfare cost burden per client of any city. The City picks up 23 percent of the welfare bill, while for most cities, the State pays all or all but a tiny fraction of the non-Federal share.

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

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

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

B. COMMPARATIVE FIGURES ON NEW YORK CITY

There is much to criticize with respect to New York City's spending on public services, pensions and other employee benefits, and debt management. But it would be a mistake to infer from this that those salaries and service costs are out of line with other local jurisdictions.

A Background Paper on "New York City's Fiscal Problem," issued by the Congressional Budget Office on October 10, 1975, brings this matter into perspective. It points out that New York's spending appears high because the city provides many services that in other metropolitan areas are supplied by county government, school districts, or other specialized units of local government. All of these come directly out of the city budget, rather than being spread around the budgets of a number of local governmental units.

Table 1, which is reproduced from the Congressional Budget Office study, compares New York with other larger central cities in terms of spending for common municipal functions—education, highways, police and fire protection, sanitation, parks, and general administration. New York spends $435 per capita for these services and ranks fifth in the country, behind San Francisco ($488), Baltimore ($470), Newark ($449) and Boston ($441).

TABLE 1.—NEW YORK CITY COMPARED TO OTHER LARGE CENTRAL CITIES, EXPENDITURES, EMPLOYMENT, AND OTHER DATA

	(1)	(2)	(3)			(4)		
			Per capita expenditures 1972–73			Local government employment per 10,000 population 1974		
				All local governments [1] serving central county			All local governments [1] serving central county	
City	Index of central city disadvantage	Fraction of population receiving welfare payments [1]	Central city government	Total	Common municipal functions [2]	Central city government	Total	Common municipal functions [2]
			(a)	(b)	(c)	(a)	(b)	(c)
New York City	211	12.4	$1,224	$1,286	$435	517.1	528.2	242.9
Boston	198	16.9	858	756	441	378.0	465.0	219.2
Chicago	245	11.1	267	600	383	140.0	352.5	208.4
Newark	422	14.4	692	827	449	391.1	421.5	258.2
Los Angeles	105	8.0	242	759	408	162.2	401.1	206.2
Philadelphia	205	16.2	415	653	395	163.8	414.5	255.2
San Francisco	105	9.1	751	1,073	488	312.5	488.3	224.6
New Orleans	168	11.4	241	431	260	177.3	357.7	217.5
St. Louis	231	15.8	310	610	360	241.9	424.6	214.2
Denver	143	7.2	473	721	375	237.0	410.5	219.3
Baltimore	256	16.3	806	814	470	434.1	434.1	260.1
Detroit	210	11.1	357	650	396	194.8	354.3	202.4

[1] Central county.
[2] Common municipal functions include elementary and secondary education, highways, police, fire, sanitation, parks, general control, and financial administration.

New York has become notorious in recent months for its numerous public employees, but the table shows that New York employment per 10,000 residents for the common municipal functions is 242.9, which is less than Newark (258.2), Philadelphia (255.2), San Francisco (244.6) and Baltimore (260.1).

What about salaries? Table 2, also from the Congressional Budget Office study, compares the average salaries of public employees for our twelve largest cities. The table confirms that New York's sanitation workers, referred to often in hearings and in the press, are indeed the highest paid in the country. It also shows that other cities pay their employees more than New York does in some categories. Los Angeles and San Francisco both pay their firemen more on an average, and Detroit pays its policemen more. New York's teachers rank fourth on the comparative pay scale. They earn an average of $17,440 a year, as compared with Detroit's teachers at $22,603, Chicago's at $20,891 and St. Louis' at $17,545.

TABLE 2.—NEW YORK CITY COMPARED TO OTHER LARGE CENTRAL CITIES: SALARIES

	(5)				(6)	(7)	
	Public employee average salaries 1974				Cost of BLS's intermediate family budget (index 1974)	Debt outstanding per capita 1972–73 [1]	
City	Teacher	Police	Fire	Sanitation		Total	Short-term
	(a)	(b)	(c)	(d)		(a)	(b)
New York City	$17,440	$14,666	$16,964	$15,924	$116	$1,676	$352
Boston	16,726	14,352	13,844	10,666	117	1,385	334
Chicago	20,891	14,146	15,525	11,956	103	733	169
Newark	16,464	13,282	13,282	8,473	116	616	112
Los Angeles	15,670	15,833	21,180	13,168	98	650	14
Philadelphia	15,354	14,354	13,869	13,337	103	1,015	101
San Francisco	15,743	15,529	17,765	13,023	106	1,225	151
New Orleans	10,458	10,746	10,645	4,170	NA	770	39
St. Louis	17,545	11,748	13,185	9,593	97	731	49
Denver	13,505	12,907	14,198	10,258	95	786	52
Baltimore	12,727	10,098	10,980	8,126	100	609	45
Detroit	22,603	15,636	16,107	13,814	100	658	63

[1] Central county.

Sources:

1 — Richard Nathan "The Record of the New Federalism: What It Means for the Nation's Cities." Brookings Institution, 1974.
2 — Department of Health, Education, and Welfare, recipients of public assistance money payments and amounts of such payments by program, State, and county. February 1975 DHEW Pub. No. (SRS) 76-03105 NCSS report A-8 (February 1975). Includes AFDC and general assistance recipients.
3a — U.S. Bureau of the Census, "City Government Finances in 1972–73," GF-73, No. 4.
3b, c, 7 — U.S. Bureau of the Census, "Local Government Finances in Selected Metropolitan Areas and Large Counties 1972–73," GF-73, No. 6.
4 and 5 — U.S. Bureau of the Census, "Local Government Employment in Selected Metropolitan Areas and Large Counties 1974," GF-74, No. 3.
6 — Bureau of Labor Statistics, "Autumn 1974 Urban Family Budgets and Comparative Indexes for Selected Urban Areas." (Apr. 9, 1975.)

All this is not to say that there are no problems with New York's public employment. The Committee is concerned about the number of employees, the size of salaries, and particularly the amount of fringe benefits New York offers, such as non-contributory pensions. There have been cutbacks already, and there will have to be more cutbacks as New York goes down the hard road to fiscal accountability. But the image of profligate New York outspending everybody on everything is not entirely accurate.

The welfare problem deserves a separate mention. While in most cities the State picks up the entire non-Federal share, including personnel and payroll, New York City foots a quarter of the nation's highest welfare bill, and all the city's welfare workers and their salaries appear in the City's budget. Compare this with cities like Boston and Philadelphia, where the State pays for all welfare costs, and New York City's budget takes on a different perspective.

A final set of figures casts light on another aspect of New York City's problem. That is the relatively small amount of Federal money which the City receives, as compared with its population and its great needs. A number of witnesses at the Committee's hearings pointed out that General Revenue sharing and other Federal grant programs are based on formulas which discriminate against the largest cities with the greatest problems. New York City, the biggest of them all, has also been one of the hardest hit, as an analysis of figures indicating Federal share of total city revenues will show. In fiscal year 1974, the latest figures available, the Federal government contributed 4.8 percent of New York City's total revenues from all sources. This is by far the lowest of any of the 28 largest cities. The average Federal contribution to those cities' total revenues was about 15 percent, and many were higher: Portland, Oregon at 19.9 percent, Chicago at 17.7 percent, Phoenix at 19.5 percent, and Pittsburgh at 30.6 percent.

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

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

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

What steps have been taken to date?

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

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

In the meantime, city employees agreed to a one-year wage freeze during the fiscal year beginning on July 1.

By the end of the summer, it became apparent that the MAC effort would not suffice to get the City back into the credit markets.

The State Legisltaure then met in Special Session in September and took extraordinary steps to save the City from default and force it to make progress toward a balanced budget.

The Legislature took the following actions:

It approved a commitment of State and pension funds to meet the City's financing requirements until December 1, 1975.

It appropriated $750 million of State funds to help the City.

It adopted a measure mandating the City to arrive at a balanced budget in the fiscal year ending June 30, 1978, and to show substantial progress toward balancing its budget in fiscal year 1976 and fiscal year 1977.

To direct this major effort to steer the City away from the shoals of default, the Emergency Financial Control Board (EFCB) was established, with full power to direct the City's three-year Financial Plan. Members of the Board include the Governor and the State Comptroller, the Mayor and City Comptroller, and three management leaders from the private sector.

The effect of this action has been to put the entire admiinstrative machinery of New York City into trusteeship of a Board with extensive powers to determine all revenue estimates, receive all City revenues into its own account and disburse them only in accordance with the financial plan, review and pass on all major contracts, approve all City borrowing, and extend a freeze on wages through fiscal year 1977.

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

Since the first of the year the City has reduced employment by 31,000, a cut of over 10%. It has reformed its accounting practices, raised subway fares by 43%, increased taxes by $330 million, and installed a new Deputy Mayor for Fiscal Affairs drawn from private industry.

D. POTENTIAL FOR DEFAULT

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

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

Numerous witnesses before the Committee testified that the December 11 borrowing needs are not likely to be met out of the current resources of the City and State. Felix Rohatyn, Chairman of the Municipal Assistance Corporation, now charged with the responsibility of covering the City's borrowing requirements, gave this measured assessment of the City's standing on that date.

If we do reach December 1, we will have raised close to $4 billion, involved the state to the extent of $750 million, and scraped every known resource available to MAC, the City and the State. By December 1st there may be some avenues still open to us in a limited way, but absent an assured financing mechanism that would enable us to fund out our three-year plan, the odds against our winning are exceedingly long.

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

New York City's borrowing needs through the end of this fiscal year, June 30, 1976, come to a total of $4.1 billion. This volume of borrowing is necessary to cover a debt roll-over of $2.6 billion, a capital program of $1.0 billion, and an operating deficit of $516 million. If the City can scrape through to the end of fiscal year 1976, and is unable to replace its maturing short-term debt with long-term securities, then it faces total fiscal year 1977 borrowing needs of $5.9 billion—and this is assuming that all the major budget cuts contained in the Financial Plan are in fact carried out. In fiscal year 1978, the City will have to borrow $6.8 billion. Table 3 summarizes the relevant data. On top of all this there are the intra-year borrowing requirements of between $1 billion and $2 billion that the City faces continually, when it has to borrow to cover its immediate cash needs because of seasonal shortfalls in tax revenues.

TABLE 3.—NEW YORK CITY'S BORROWING NEEDS

[In billions of dollars]

	Fiscal year—		
	1976 [1]	1977	1978
Debt rollover	$2.6	$4.3	$5.9
Operating deficit	.5	.5	0
Capital program	1.0	1.1	.9
Total	4.1	5.9	6.8

[1] From Dec. 1, 1975, to June 30, 1976.

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

V. Economic Impact of a New York City Default

A. ON THE CITY

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

Immediate Problems

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

> Nobody has ever defaulted before in this dimension or this size. This is not a big business going into default or a small business going into default. This is the City of New York going into default and there are a host of relationships which have existed between creditors and debtors and sellers and vendors to the city that have just existed for dozens and dozens of years because they exist.
>
> Now when you go into default all of those relationships become open to question for the first time. Bank accounts can be attached. Setoffs can be claimed. Money that the City thought that it had ready to pay checks with might be grabbed by attachment or otherwise by somebody else. Welfare checks begin bouncing.
>
> With all the planning in the world and with all the foresight in the world, since there's no form book to go to see what happens when a municipality the size of New York defaults, there isn't anybody who can tell you what happens the next day on the streets. Will the garbage men stay in the trucks—I don't know—if those checks are stopped? There were rumors yesterday that possibly they might not. Will the banks honor bank accounts or setoffs? I don't know. Nobody knows exactly what's going to happen until they are faced with that possibility. Will litigation begin as between various holders of securities contesting each other as to who has priority? Nobody knows because this never happened before.

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

> As I evaluated the cash flow on Friday, I discovered the following—
>
> Nothing for hospitals, nothing for social services, nothing to pay vendors for the delivery of food, toiletries, essential supplies to the city facilities, nothing for any purpose whatever during the course of the ensuing week.

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

Longer Run Problems

The legal aftermath of default raises additional questions about the City's ability to keep going. The City would go into court, and the court is empowered to grant a 90-day stay of all litigation, while it works out a restructuring of the City's debt. However, there is still a possibility that the City will be required under law to meet its debt service payments out of current revenues before it pays for city services. Another legal question involves welfare and Medicard payments—

a large chunk of the City's budget. If the City cannot meet its matching contributions, then can the Federal and State contributions—50 and 25 percent respectively—be paid out? And once the 90-day stay expires, there is bound to be an onslaught of lawsuits from vendors, investors and others whose legal connections with the City left them damaged by default. New York could be tied up for years in a maze of default inspired litigation.

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

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

The main impact will be a steep reduction in the real estate taxes the City could collect. Under the State constitution, all real estate taxes over 2½ percent of assessed value have to be used to pay off debt service. If the City failed to use the tax monies for this purpose, because of default, then about 43 percent of the real estate tax levy—some $1.4 billion a year—might not be collectable.

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

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

B. ON THE STATE

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

A default by the City would cause further budget problems for the State, which already faces a $600 million deficit. It would at minimum delay repayment of a $250 million loan extended by the State to the City. In addition, the City's budget reductions could also cut into State revenues, to the tune of $100 to $150 million.

More important, the State's access to the credit market could be closed if the City defaults. The State's full faith and credit securities have already met with stiff investor resistance, and a City default could close the market to the State altogether. New York State does

not have major borrowing needs until the second quarter of 1976, but at that time, it will have to borrow $2.7 to 3.5 billion to cover State aid payments to all localities around the State. If the State cannot borrow this money and make the payments at that time, then many local governments in New York could be pushed into default.

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

> Our State wil be spotted with empty monuments to default, partially built classrooms, dormitories, public and private hospital mental health facilities, day care centers, nursing homes, water pollution control facilities, and housing for low and middle income families, to name a few of the ongoing projects—will forever stand as only steel and concrete.
>
> Our sick, our elderly, our children in need of education, our working mothers and all of our citizens will forever be denied the vital services those facilities were designed to provide.
>
> Billions of dolars in capital will be wasted.
>
> More than 53,000 workers who depend on these four agencies for their livelihood will be sent to thee unemployment lines.

C. OR THE MUNICIPAL BOND MARKET

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

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

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

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

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

TABLE 4.—RATIO OF YIELDS ON LONG-TERM TAX-EXEMPT SECURITIES TO YIELDS ON LONG-TERM TAXABLE CORPORATE SECURITIES

	Total [1]	Aaa	Baa
1970	0.754	0.761	0.741
1971	.708	.706	.688
1972	.695	.699	.686
1973	.669	.671	.666
1974	.689	.687	.687
1975 (average of 1st 9 mo)	.733	.721	.720
1974:			
September	.700	.702	.709
October	.699	.670	.671
November	.681	.682	.668
December	.736	.748	.711
1975:			
January	.721	.724	.702
February	.686	.691	.674
March	.722	.724	.705
April	.732	.722	.719
May	.728	.721	.715
June	.737	.716	.720
July	.750	.723	.736
August	.749	.715	.745
September	.775	.751	.767
October (1st 3 weeks)	.784	.762	.778

[1] Includes bonds that are rated Aa and A.

Source: Federal Reserve Bulletin.

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

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

In addition, short-term tax-exempt rates have risen 50 basis points, imposing an additional cost of $150 million a year according to JEC estimates. Thus, State and local governments will incur additional interest costs of $300 million this year and an additional $150 million a year for at least the next nine years.

While the rise in all tax-exempt interest rates has been significant, the problems are clearly the greatest for the lower quality issuers. As

Table 5 shows, the spread between Aaa and Baa issues has almost doubled over the last year. This widening spread indicates greater investor skepticism about all but the most secure investments.

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

1970	.63
1971	.77
1972	.56
1973	.50
1974	.64
1975 (Average of first nine months)	1.12
1974:	
September	.69
October	.78
November	.95
December	.85
1975:	
January	1.06
February	1.07
March	.97
April	.97
May	1.06
June	1.20
July	1.21
August	1.31
September	1.24
October (first three weeks)	1.27

Source: Federal Reserve Bulletin.

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

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

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

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

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

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

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

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

The impact of higher rates would be especially severe on cities with lower bond ratings. Most of those cities are well managed and credit-worthy. But in the wage of a New York City default, investors would demand higher yields on lower rated issues—those with A or Baa ratings. A list some of those cities is included under table 6.

In short, while no one can predict with perfect confidence the effect of default on the municipal bond market, it is safe to conclude that default would be a major event which would inevitably push interest rates higher and could cause temporary market access problems, thus precipitating further defaults.

TABLE 6.—*Cities with an A or lower bond rating*

[Ratings are Standard & Poor's except those asterisked, which are Moody's]

Alabama:	
Mobile	BBB.
Montgomery	A.
Alaska:	
Anchorage	BBB+.
Fairbanks	BBB.
Arizona:	
Tucson	A+.
Tempe	A+.
Florida:	
Hollywood	A.
Miami	A+.
St. Petersburg	A.
Tampa	A.
Georgia: Macon	A+.
Illinois:	
Decatur	A.
Cicero	A.
Indiana: Gary	BBB.
Kentucky:	
Covington	A.
Lexington	A+.
Louisville	A.
Louisiana:	
Baton Rouge	BBB.
Lafayette	A.
Lake Charles	A.
Monroe	BBB+.
Shreveport	A.
New Orleans	A.
Maryland:	
Baltimore	A.
Rockville	A+.
Massachusetts: Boston	A.
Michigan:	
Dearborn	A.
Detroit	A, Baa*.
Livonia	A.
Warren	A+.
Minnesota: Bloomington	A.
Mississippi:	
Biloxi	BBB.
Hattiesburg	A.
Jackson	A.
Missouri:	
Jefferson City	A.
St. Louis	A*.
Montana: Missoula	BBB.
New Jersey:	
Bayonne	A.
Camden	BBB.
East Orange	A.
Jersey City	BBB+.
Newark	BBB.
Trenton	A.
New Mexico: Las Cruces	A.
New York:	
Albany	A.
Buffalo	A.
New York City	[1]
Niagara Falls	A.
North Carolina:	
Asheville	A.
Fayetteville	A.
Gastonia	A.
Wilmington	A.
North Dakota: Minot	A+.
Ohio:	
Cleveland	A*.
Youngstown	A.
Canton	A.
Springfield	A.
Pennsylvania:	
Philadelphia	A.
Erie	A.
Harrisburg	A.
Altoona	A.
Wilkes-Barre	A.
Chester	BBB.
Rhode Island:	
E. Providence	A.
Woonsocket	A.
South Carolina:	
Greenville	A.
Spartanburg	A.
Rock Hill	A.
South Dakota: Aberdeen	A.
Tennessee: Knoxville	A+.
Virginia:	
Virginia Beach	A+.
Hampton	A.
Chesapeake	A.
Washington:	
Spokane	A.
Tacoma	A.
Wisconsin: West Allis	A+.
Wyoming: Sheridan	A.

[1] Rating suspended.

D. ON THE BANKING SYSTEM

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

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

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

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

The latest FDIC survey reveals that there are a total of 283 nonmember State banks in 40 States (including Puerto Rico) which currently hold more than 20 percent of their net worth in New York State, New York State agency, and New York City obligations. A list of those States and the banks in each category is shown in Table 7. Forty-five of these banks have over 70 percent of their net worth in

these securities. Ten States have ten or more banks in that situation: Alabama, Arkansas, Florida, Illinois, Louisiana, Mississippi, Missouri, New York, Tennessee and Texas.

TABLE 7.—SPECIAL SURVEY OF NEW YORK CITY OBLIGATIONS TO OCTOBER 31, 1975

	Insured nonmember banks having current book value holdings of New York City obligations as a percent of capital and reserves of—			
	20 to 50 percent	50 to 70 percent	Over 70 percent	Total
Alabama	17	1	1	19
Alaska				
Arizona				
Arkansas	16	9	3	28
California				
Colorado	3			3
Connecticut	1			1
Delaware				
District of Columbia		1		1
Florida	27	2	5	34
Georgia	1	2		3
Hawaii				
Idaho	1			1
Illinois	23	5	2	30
Indiana	2			2
Iowa				
Kansas	8	1		9
Kentucky	1			1
Louisiana	12	2	1	15
Maine				
Maryland	1		1	2
Massachusetts	1			1
Michigan		2	1	3
Minnesota	1			1
Mississippi	7		1	8
Missouri	19	5	3	27
Montana				
Nebraska	5			5
Nevada				
New Hampshire	1			1
New Jersey	1			1
New Mexico				
New York	10	3	3	16
North Carolina	1			1
North Dakota	3	3		6
Ohio				
Oklahoma	2			2
Oregon				
Pennsylvania	3			3
Rhode Island				
South Carolina	1			1
South Dakota	3			3
Tennessee	22	1		23
Texas	18	1	2	21
Utah				
Vermont				
Virginia	1	1		2
Washington	2			2
West Virginia	7	1		8
Wisconsin	3			3
Wyoming				
Other areas				
Guam				
Puerto Rico	1			1
Virgin Islands				
Total	225	40	23	288

It appears that the banking system as a whole could probably absorb the impact of a New York default without major disruption. The Chairman of the Federal Reserve Board has indicated that the Fed will lend unlimited funds through the discount window to any member or nonmember bank with temporary liquidity problems. The FDIC can assist insured banks that require temporary infusions of new capital. And all the agencies will allow banks to suspend the write-down of defaulted assets for six months. These actions should minimize the shock of default.

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

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

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

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

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

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

E. ON THE ECONOMY

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

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

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

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

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

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

One study prepared for the Senate Budget Committee by Professors F. Gerard Adams and James M. Savitt estimates that a New York City default could increase municipal bond rates by 100 basis points (one percentage point). The authors estimate that this increase in municipal bond interest rates would lead to a cut-back of $3.4 billion in State and local spending in 1976 and $6 billion in 1977. On these assumptions, they predict a GNP loss of $4.8 billion in 1976 and $10 billion by mid-1977, and a rise in unemployment of 430,000 by that date.

Otto Eckstein presented a similar estimate to the House Banking Committee. Eckstein predicted an $18 billion loss in GNP by mid-1977 and an increase in unemployment of 300,000.

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

VI. Policy Options Considered by the Committee

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

OPTION THREE: THE BANKRUPTCY APPROACH

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

There is a widespread consensus that the present provisions of the Bankruptcy Act contained under Chapter Nine make it impossible for large cities to apply for bankruptcy. These provisions require that creditors holding 51% of the city's debt must first agree to a restructuring plan before the city can petition the court.

After that, creditors representing two-thirds of the city's debt must agree to any final plan. Considering the fact that most of New York City's obligations are held in bearer form by more than 160,000 bond and note holders, it would be a formidable task to even locate these creditors, let alone obtain their timely-approval of a plan for restructuring the City's debt. The amendments to the Bankruptcy Act pro-

posed by the President would permit large cities to file a bankruptcy petition without prior agreement of 51% of their creditors and would require that only two-thirds of those creditors actually voting approve the final restructuring plan.

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

While the bankruptcy route may enable the City to get out of paying some of its bills, at least temporarily, it would not solve all of the City's short-term financing problems. Even if all debt service payments towards principal and interest were suspended (which may be difficult to achieve), the City would still be short $1.2 billion from December 1, 1975 through March 31, 1976 due to the seasonal imbalance between its revenues and expenditures.

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

In addition, it is questionable that payments on the MAC debt could be postponed since the revenues to service that debt are segregated and are controlled by the State, which is also a major holder of MAC paper. The inability to suspend payments on MAC debt would increase the City's cash deficit by another $600 million.

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

Finally, it is doubtful that the State of New York would go ahead with its plan to advance the City $800 million in aid payments in April if the City is in default. Thus, the net cash deficit could total $2.5 billion for the balance of fiscal year 1976 even if the City goes into bankruptcy. At the very least the City would have to finance a deficit of $1.2 billion over 4 months and most likely would be required to finance a deficit of $2.5 billion over seven months.

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

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

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

OPTION TWO: AID AFTER DEFAULT

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

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

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

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

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

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

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

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

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

The State Emergency Financial Control Board has already approved a plan for bringing the City's budget into balance in just 20 months. This plan, after allowing for inflation and uncontrollable items, will require a real spending cut of over 20% in the controllable portion of the City's budget. The Committee does not believe a faster time table can be imposed on the City without seriously jeopardizing the welfare of its 8 million residents.

There is no reason for assuming a bankruptcy judge could do a better job of supervising the City than the Governor of the State of New York and the other members of The Emergency Financial Control Board. These individuals have placed their political and professional reputations on the line and have every incentive to ride herd on the City until its budget is balanced and investor confidence is restored. A bankruptcy judge operates under a wholly different set of imperatives and limited powers. He would be more concerned with legal questions such as fairness to different classes of creditors. Moreover, the existence of a bankruptcy judge would, to some extent, take the Governor and The Emergency Financial Control Board off the hook. Any failure to achieve the necessary fiscal reforms could be blamed on the Federal bankruptcy judge rather than on State officials.

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

OPTION ONE: PREVENT DEFAULT

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

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

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

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

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

The bill also requires that the holders of 40 percent of the City's debt maturing prior to June 30, 1976, must agree to accept non-guaranteed long term city bonds at an appropriately low rate of interest. This requirement will reduce the amount of Federal guarantee assistance needed by $1.2 billion and enable the City to avoid the problem of constant borrowing to roll over its short term debt.

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

Finally, the bill contains a standby program for meeting the emergency credit needs of the City in the event that all of the stringent conditions cannot be met and the City defaults. The standby program under secion 6 of the bill authorizes loan guarantees of up to $500 million to enable the City to continue services essential to health, safety and welfare. The term of the guarantee could not exceed three months and the authority to make the guarantees would expire on March 31, 1976.

The standby program under section 6 is intended as only a temporary device for helping the City to meet its essential needs in the period immediately following a default. During this time, Congress would have to consider and act upon a longer range program for helping the City to meet is borrowing needs. As indicated elsewhere in this report, the Committee believes the requirements for Federal aid after default will exceed the amount authorized and will continue far beyond the expiration of the legislation reported by the Committee.

The legislation further provides that if the obligations guaranteed under the bill are made taxable through subsequent legislation, the guarantee fee ceiling would be reduced to one percent. The Committee believes that these obligations should be taxable in order to avoid giving New York city a preferred position in the market for tax-exempt securities. Moreover, since the rate on taxable securities will be substantially higher than the rate on equivalent tax-exempt securities, a requirement that the New York City guaranteed securities be taxable will discourage other cities from requesting similar assistance from the federal government. Finally, the U.S. Treasury will earn additional tax revenues on taxable New York City bonds and these additional revenues will provide further security to the Federal government's exposure under the guarantee program.

For all of the foregoing reasons, the Committee recommends that the Congress enact subsequent tax legislation making the guaranteed New York State securities taxable. In the meantime, the Committee believes that the maximum guarantee fee of 3½ percent provided for in the bill will give the Federal Board the flexibility to set the rate paid by the city at a level equivalent to a taxable issue. In order to avoid the problem of having guaranteed, tax-exempt securities adversely impacting the municipal bond market, the bill further provides that until these securities are made taxable, they must be purchased by the Federal Financing Bank, an agency under the control of the Secretary of the Treasury. This will remove these securities from the tax-exempt market and thus make it easier for other State and local governments to borrow at reasonable rates.

COST OF THE LEGISLATION

In compliance with Sec. 252(a)(1) of the Legislative Reorganization Act of 1970, as amended (2 U.S.C. 190j), the Committee estimates there will be no cost to the Federal Government in carrying out the provisions of the legislation. Any administrative expenses involved in carrying out the legislation would be paid from the guarantee fee authorized under sections 5 and 6. The Committee knows of no estimate of a Federal agency indicating any cost of carrying out the legislation.

VII. Section-by-Section Analysis of the Bill

SHORT TITLE AND STATEMENT OF PURPOSE

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

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

DEFINITIONS

Section 2 defines for purposes of the Act the terms "Board," "applicant," "assisted municipality," "State," and "Governor."

ESTABLISHMENT OF THE BOARD

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

AUTHORITY OF THE BOARD

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

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

STANDARDS AND CONDITIONS FOR GUARANTEES TO PREVENT DEFAULT

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

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

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

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

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

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

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

Section 5(a)(6) provides that the State or agency must pay to the Board a guarantee fee of not more than 3½ percent on the obligations guaranteed. If Congress passes legislation subsequently to require that the obligations be taxable rather than tax-exempt, then the guarantee fee will drop down to one percent.

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

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

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

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

Section 5(b)(2) sets the conditions for phasing out Federal guarantee assistance over time by limiting the amount of guaranteed obligations outstanding at any time to $4 billion through June 30, 1977, $3.5 billion through June 30, 1978, $2.5 billion through June 30, 1979, $1.5 billion through June 30, 1980, and zero thereafter.

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

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

STANDARDS AND CONDITIONS FOR GUARANTEE OF OBLIGATIONS OF ISSUERS IN DEFAULT

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

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

Section 6(a)(2) requires the municipality or other issuer of obligations guaranteed under this section to submit a financial plan for achieving a balanced budget, in accordance with accounting principles prescribed by the Board.

Section 6(a)(3) requires the issuer to provide satisfactory assurances that it will repay any losses sustained by the Federal Government as a result of guarantees furnished under this section. The municipality must pledge as security against such losses the payments it is entitled to receive under general revenue sharing or any other comparable general purpose financial assistance program of the Federal Government.

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

Section 6(a)(5) provides that the issuer must pay to the Board a guarantee fee of not more than 3½ percent on the obligations guaranteed. If Congress passes legislation subsequently to require that the obligations be taxible rather than tax-exempt, then the guarantee fee will drop down to one percent.

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

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

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

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

EMERGENCY MUNICIPAL DEBT GUARANTEE FUND

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

Section 7(b) requires that there be deposited in the fund any guarantee fees paid into the Act, any payments under general revenue sharing or other Federal assistance programs waived by a State or municipality to cover losses, or any other sums received by the Board.

Section 7(c) provides that payments required to be made as a result of any guarantee by the Board shall come out of the fund, and if there is not enough money in the fund, then the Secretary of the Treasury is authorized to borrow in order to make these payments.

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

FEDERAL RESERVE BANKS AS FISCAL AGENTS

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

PROTECTION OF GOVERNMENT'S INTEREST

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

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

REPORTS

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

TERMINATION

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

STOCK TRANSFER TAX

Section 12 amends Section 28(d) of the Securities and Exchange Act to permit a State or political subdivision to impose a transfer tax where the basis of the tax is the transfer and issuance of a new certificate by a transfer agent.

MINORITY VIEWS

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

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

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

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

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

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

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

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

To be sure, once the initial guarantee has been extended, the Federal Government could simply refuse to extend new guarantees to cover maturing obligations of the city if the preconditions for obtaining such guarantees are not met. By then, however, the financial interests of the Federal Government will be intertwined with the financial affairs of the city. The Federal Government will be faced with the likelihood of losing billions of dollars under already-outstanding guarantees or extending additional guarantees to avoid incurring such losses. Under the bill reported by the Committee, the maximum exposure facing the Federal Government could total $4 billion to fiscal year 1976 alone and $3.5 billion in fiscal year 1977. It can and will be argued that there is never a good time to permit a default by New York City. The end result will be that, in an effort to prevent a default from occurring, the Federal Government would become entangled in the city's financial affairs and policy decisions for an indefinite period into the future and on a scale yet unanticipated.

In addition, the extent to which Federal assistance would be needed to avoid default is unknown. The bill reported by the Committee provides for a maximum of $4 billion in guarantees this fiscal year. The maximum amount of guarantees which could be outstanding at any one time would decline each year thereafter. However, estimates by New York City officials of the need for Federal assistance through guarantees range as high as $9 billion. The fact is that accurate figures on how much aid would be required under the approach embodied in the reported bill simply do not exist.

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

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

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

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

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

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

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

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

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

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

As noted above, the second approach considered by the Committee was to provide Federal loans to maintain essential city services during any period of cash shortage which could develop should default occur.

The President's proposal could be supplemented by this second approach, which recognizes that the marketability of the debt certificates proposed under the President's plan is open to some question.

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

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

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

John Tower.
Edward W. Brooke.
Jesse Helms.
Jake Garn.
Robert Morgan.

ADDITIONAL VIEWS OF SENATOR EDWARD W. BROOKE

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

New York City's problems are many and intertwined. Yes, New York has absorbed large numbers of low-income immigrants, both from abroad and from sections of our own country, as have some of our other Northeastern cities. Yes, New York has attempted to provide a decent standard of living for its lower income residents, as have some of our other cities. Yes, New York, like other cities, has watched many of its middle and upper income residents move to suburban enclaves, zoned to protect them from the problems of the poor who remain in the city. But New York City has also grossly mismanaged its affairs. The city's municipal work force grew from approximately 245,000 in 1960 to almost 300,000 in 1975, while its population declined from approximately 7,800,000 to approximately 7,500,000 over the same period. City employees enjoy pensions and fringe benefits which are generous by any standard and are beyond the financial means of the city. The city has subsidized not only its poor, but its middle and upper income residents, through such devices as rent controls and free college education regardless of income. And the city has engaged in budgetary gimmickry to such an extent that even today it is impossible to determine with any confidence the true state of the city's finances.

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

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

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

EDWARD W. BROOKE.

ADDITIONAL VIEWS OF SENATOR HELMS

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

JESSE HELMS.

H. R. 10481

Ninety-fourth Congress of the United States of America

AT THE FIRST SESSION

Begun and held at the City of Washington on Tuesday, the fourteenth day of January, one thousand nine hundred and seventy-five

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 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.

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. 191) the term "person" includes the city or any financing agent.

LIMITATIONS AND CRITERIA

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 $2,300,000,000.

(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

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 $2,300,000,000. 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 to the Federal Financing Bank and, in addition to its other powers, such Bank is authorized to purchase, receive, or otherwise acquire the same.

(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.

Speaker of the House of Representatives.

Vice President of the United States and
President of the Senate.

December 8, 1975

Dear Mr. Director:

The following bills were received at the White House on December 8th:

H.R. 8069
H.R. 10481

Please let the President have reports and recommendations as to the approval of these bills as soon as possible.

Sincerely,

Robert D. Linder
Chief Executive Clerk

The Honorable James T. Lynn
Director
Office of Management and Budget
Washington, D. C.