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2PM - Meeting with thePresident and
Mayor Beame and Hugh Carey
Re: New York Fiscal situation

Tuesday, May 13, 1975

THE PRESIDENT HAS SEEN

THE WHITE HOUSE

WASHINGTON

MEETING WITH GOVERNOR HUGH CAREY
AND MAYOR ABE BEAME

Tuesday, May 13, 1975
2:00 p.m. (45 minutes)
The Oval Office

From: Jim Cannon

I. PURPOSE

This meeting was requested by Governor Carey and Mayor Beame to apprise you of the fiscal crisis that New York City faces in the next two weeks and to appeal Secretary Simon's decision not to support legislation giving Treasury authority to loan New York City Federal funds.

This will provide you an opportunity to explain to them the problems the Federal government would have if it were to consider the fiscal crisis of one major municipality without at the same time considering the fiscal crisis of all other state and municipal governments who are experiencing similar financial difficulties. In addition, you may want to point out to the Mayor that you recognize that the current fiscal crisis has not developed overnight but rather results from a long series of decisions which has now precipitated this crisis.

II. BACKGROUND, PARTICIPANTS & PRESS PLAN

A. Background: Attached at Tab A is a brief memorandum Dick Dunham has put together covering the New York City problem. Also attached (Tab B) is a summary of Treasury's views on the impact of the problem.

This morning Jerry Jones passed on your request for additional budget information on New York City. We are in the process of pulling that together.

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B. Participants: The Vice President, Governor Carey, Mayor Beame, Secretary Simon, Bill Seidman, Jim Lynn, Alan Greenspan, Jim Cannon, Dick Dunham, and Secretary Dunlop.

C. Press Plan: To be announced. Photo opportunity.

Options

1. Immediate announcement by statement through Ron Nessen. Draft statement being revised by Paul Theis, is at Tab C.

2. Ron Nessen and Jim Lynn to brief press on what happened at the meeting and to make clear the President's position.

3. President himself to go to briefing room and summarize statement for the cameras. Leave and have Ron Nessen or Jim Lynn brief on the meeting and take questions.

4. The President considers the request from Mayor Beame and Governor Carey for 24 hours, then announces his decision, or have Jim Lynn announce it.

Domestic Council staff recommends Option 3.

III. TALKING POINTS

1. I have followed the situation closely and I am fully aware of your fiscal problem.

2. I am very sympathetic with your plight and very sympathetic with the people of New York City. You are up against a hard problem.

3. Call on Governor Carey.

4. Call on Mayor Beame

THE WHITE HOUSE

WASHINGTON

May 12, 1975

MEMORANDUM CONCERNING NEW YORK CITY FINANCIAL CRISIS

The President will meet with Governor Carey and Mayor Beame on Tuesday, May 13, 1975, concerning the possible insolvency of New York City which could occur on or before May 23.

PROBLEM

The insolvency will occur unless the City can borrow on a short term basis by May 20 about $750 million to meet various payrolls, BAN*maturities and other expenses.

Three major N.Y.C. banks have notified Mayor Beame, Governor Carey and Secretary Simon that they cannot market New York City short or long term debts in the amounts required over the next 4 months.

BACKGROUND

There are three elements to the problem and the solution to the short term financing problem lies in a credible and realistic solution to the other two.

These are:

1. The City needs to borrow on a short term basis about $3.5 billion before the end of August. These tax anticipation notes would be used to finance the City's cash flow until property taxes or other payments are received in major amounts in the Fall.

2. The City must adopt by July 1, a 1975-76 Budget that is in balance. Mayor Beame states that there is a gap of $600-800 million between estimated expenditures and estimated income that must be covered by new taxes, increased State or Federal aid or city service cuts.

3. There is a long term imbalance between revenues and expenses which lie at the heart of the problem.

*Bond Anticipation Notes

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Over the last five years, City revenues (excluding State and Federal aid) have grown at an average rate of about 8 percent. During the same period, however, expenditure growth has averaged 15 percent.

This differential between revenues and expenditures has been funded through the use of one time revenues, accounting changes such as capitalizing current expenses, and increased short term borrowing.

See Tab A for a description of the types of methods used over the last few years which have caused the current lack of confidence in City financial paper. Most of these methods are well documented and in the public domain.

SOLUTION

Long Term

The solution to the short term financing problem is to restore confidence in the integrity of and long term balance of City revenues and expenditures.

The confidence of the financial community can probably only be restored by extensive fiscal reform, a cut back in the current level of services and expenditures, and a long term demonstration of willingness on the part of the City administration to live within the available revenues.

See Tab B for an illustrative list of possible current reductions.

See Tab C for a possible program to accomplish the long term restoration of confidence, balance, and reform.

Short Term

A reduction in City expenses for the 1975-76 fiscal year and the adoption of a longer term solution cannot realistically be accomplished within the next two weeks.

It is unlikely that a program containing elements of the above and possibly some tax increases could be accomplished much before June 30.

This leaves a cash need of the City for:

By May 15 $650 - 750 Million

By June 11 $750 - 850 Million

Total through June 30 $1.5 Billion

These short term funds will probably have to be provided through:

A. Increased use of New York State credit.

B. Refinancing by the Banks of current notes - $234 Million BAN's* and $792 Million of TAN's.**

C. Or appeals to the Federal Reserve Board.

* Bond Anticipation Notes

** Tax Anticipation Notes

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SOME COMMENTS ON THE CITY'S FISCAL SITUATION

The current fiscal imbalance situation has not developed overnight but rather results from a series of decisions made by both the Lindsay and Beame Administrations. The central theme of these decisions has been the provision of new and expanded services without regard to the present or future ability of the City to finance them. In addition, the ability of the City's powerful unions to extract exorbitant wage settlements, coupled with ineffective lower and middle management have contributed significantly to the situation in which the City finds itself.

Some of the more significant fiscal practices which have contributed to the City's predicament are outlined below.

1. Capitalization of operating expenses

An estimated $715 million of operating expenses are contained in the City's $1.7 billion capital budget for 1974-75. The City uses this device to reduce the need for tax levy monies in a given fiscal year. This practice, however, has grown to the point where it seriously erodes the City's ability to finance needed capital improvements to its aging and deteriorating physical plant (e.g. housing). Further, this practice, while legal, inevitably costs the taxpayer about 15 to 20 percent more over time because of the interest payments on the borrowed funds. Examples in 1973-74 budget, the entire cost of the vocational education program (estimated at $148 million) was transferred from the operating budget to the capital budget through a technical loophole in the law.

2. Rapid growth of debt service

Indicative of the City's growing reliance on both long and short term borrowings to achieve a "balanced" budget, the City's debt service payments will consume an estimated 16 percent or $1.8 billion of the expense budget for 1974-75 (up from 11.2 percent or $1.2 billion 1973-74). The magnitude of these payments impedes the City's ability to provide essential services and contribute to the use of fiscal gimmicks to balance the budget.

3. Underfunding pension cost

A series of articles in the New York Daily News last spring (3/25/74), indicated that the City may be seriously underfunding its entire pension program. The analysis noted that many of the actuarial assumptions have not been modified since they were made in 1917. This practice, coupled with the lucrative pension benefits agreed to by City officials and increases in the City's labor force have caused pension payments to jump from $465 million in 1972-73 to an estimated $1.1 billion in 1974-75

Dr. Bernard Jump of Syracuse University's Maxwell School indicated that retirement cost increases of $700 to $900 million per year (including social security) could reasonably be expected over the next seven years.

In addition, the Fire Department Pension fund is currently $200 million in arrears because of an impasse among members of the fund's Board of Trustees as to the respective responsibilities which the employees and the City should assume in making payments to liquidate the deficit.

Despite these factors, the City took advantage of some fiscal gimmickry to use $125 million of "excess" income in the Employees Retirement System to help "balance" the 1974-75 budget.

4. Underfunding collective bargaining settlements

In each of the last two fiscal years the City has underfunded the cost of its collective bargaining settlements by about $100 to $150 million annually. Essentially, the City assumes that contracts negotiated in one fiscal year, e.g., 1973-74, won't be settled until the following year, e.g., 1974-75. This allows the 1973-74 costs of such contracts to be paid retroactively through bonds issued under the "judgements and claims" provision of the City Charter and the State Finance Law. The effect on relative expenditure levels in the following year, e.g., 1974-75, is to double count the cost of the collective bargaining increase as the amount allocated doubles to meet the base year (1973-74) salaries plus the second year (1974-75) cost increases.

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This practice also permits the City to grant salary increases in excess of what they might normally provide since there is little effect on the City tax levy funds in the base year.

5. Placing certain expenditures on a cash basis

Although the City normally operates on an accrual basis, they have been able to generate some one-time savings by placing certain expenditures on a cash basis. For example, if the last pay period of City FY 1973-74 actually includes 5 working days of the new fiscal year, an accrual system would require counting all the expenditures in 1973-74. By switching to a cash basis, however, the City charges only 5 days expense to the 1973-74 fiscal year with the remaining 5 days expense chargeable to the following fiscal year. While an ingenious strategy, it has one major drawback - viz. in 1977, according to City officials, the accrual pay period and the cash pay period will end on the last day of the City fiscal year (June 30). Thus, the City will, in effect, be faced with an extra or 27th pay period instead of the normal 26 periods.

6. Funding from one-time sources

The foregoing is but one example of the growing tendency of the City to resort to one-time sources to balance the budget. In CFY 1974-75 about $450 million in such sources were used. In addition to the use of pension fund interest ($125 million) and the accrual to cash accounting ($32 million) noted above, other devices totalled $297 million.

The use of these financing measures to support ongoing operating expenses means that a substantial portion of the programs in the 1974-75 budget had no dependable future support. Thus as the 1975-76 budget is drafted, the City will face the prospect of cutting the programs, finding some source of ongoing support, e.g., borrowing, increasing local taxes or getting additional State or Federal Aid and/or devising a new series of one-shot gimmicks.

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Illustrative List of Possible Expenditure Changes in 1975-76 Budget

		$million
1.	End free tuition at City University Establish State University tuition rate, for those who can afford it.	
	138,000 students	60+
2.	Reduce work force. Say 10,000 employees. average salary $11,000 fringe benefits 3,300 $14,300	
	10,000 x $14,300	143
3.	Raise subway fares $0.05 From .35 to .40	50
4.	Tolls on East River Bridges	50
5.	Charge Day Care according to Federal standards	15
6.	Reduce City University salaries to State University salary rates	10
7.	Renegotiate employee contracts to require partial -- 20% contribution of employees to the retirement	200
8.	Reduction in primary and secondary education costs	100
9.	State takeover of city court system	120
10.	State takeover of correction system (tax levy cost)	90
11.	Reduction in levels of free hospital services ($340 million tax levy)	100
12.	No increase in pay levels under pending negotiations	350-400

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Elements of a Fiscal Improvement Program for New York City

1. Phase out the use of long-term borrowing to finance operating expenses over a 5 to 10 year period by amendments to the Local Finance Law. This should include requirements for disclosure of all such items now included in the capital budget or "outside the certificate."

2. Reduction of the City's short-term debt position in line with a plan for the next 12 to 18 months. This should include a program of improved advances/reimbursements of State and Federal aid.

3. Improvements in the City's financial accounting and reporting systems by means including:

   Work toward adoption of MFOA principles and standards

   Install improved accounting systems

4. Installation of a long-range fiscal planning process (3 to 5 years) for City expenditures and -- in so far as feasible -- revenues.

5. Establish a City-State fiscal commission to review aid programs, shared financing of operating programs, etc., along the lines of the Mayor's proposal.

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Proposed Comments on the Consequences of a Default by New York

Robert A. Gerard, Director
Office of Capital Markets Policy - TREASURY

There is little doubt that a default by NYC would have a substantial psychological impact on the municipal market and the capital markets generally, NYC accounts for 25% of the short term tax-exempt market; its total outstanding debt is $12-13 billion. A default on even a single note issue would severely reduce the market values of all NYC securities, if it did not close the market entirely.

On the other hand, the cataclysm threatened by some City officials and some bankers is unlikely. NYC banks hold approximately $1.25 billion of NYC securities, slightly more than 1% of their total assets. To the extent a default created liquidity problems for one or more banks, the Fed would undoubtedly step in with loans. There could be serious hardship to individual investors who need to convert to cash, but, if the City took proper measures, it would be short lived.

A default could trigger the kind of radical fiscal action by the City which is required. Such action could induce the banking community -- probably with the blessing of the Fed -- to provide the City with the cash to cure the default and conduct its affairs until enough tangible evidence of progress exists to return to the public market.

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Alan Holmes, Vice President
Federal Reserve Bank - New York City

The possible consequences of a default by New York City on its note or bond obligations are difficult to predict, but it seems reasonable to anticipate that general effects on the credit markets would be confined to NYC's own issues and to other issues regarded as having relatively weak credit standings. It is not anticipated that there would be a widespread collapse of the markets in State and local issues generally.

A major unknown in this analysis is the possible secondary effect that might stem from a significant weakening of confidence in the large New York City banks. The major banks hold sizable amounts of NYC obligations and depositors could be feared of the consequences of the City banks facing large losses or significant liquidity problems. While this result is a risk, it is by no means a foregone conclusion or even a likelihood. Available information on the exposure of large

New York City banks does not suggest that such exposure is a major proportion of capital. On the other hand, one cannot entirely dismiss the possibility of "irrational reactions" in the financial community.

J.C. Partee, Managing Director for Research & Economic Policy - Federal Reserve Board

A default on its note issues by New York City probably would not have significantly adverse effects on the national economy, assuming that the City is permitted to continue to meet payrolls and other current expenses. An austerity program undoubtedly would be forced upon New York City, and the resultant cutbacks over time in current activities would tend to increase the already substantial unemployment problem in that area. Some other hard-pressed communities and governmental entities, adversely affected by increased investor sensitivity to the risk factor in tax exempt securities, might also be compelled to curtail some activities for lack of financing. But the scale of these direct impacts would be very small relative to the overall economy.

Potentially more damaging to the economy would be the possible psychological effects of a New York City default. Banks and other lenders might tighten up on their credit standards generally. Consumers, confronted with this new evidence of weakness in the financial structure of the country, could become even more cautious in their spending behavior. Markets for stocks and corporate bonds could suffer a reaction, with selective declines in those issues judged to be of doubtful or marginal quality. Such a reaction, if it developed, would obviously weaken the prospects for recovery in business capital spending, construction, and postponable consumer expenditures.

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DRAFT STATEMENT BY THE PRESIDENT May 12, 1975

New York City faces a financial crisis, and I am sympathetic to Governor Carey and Mayor Beame and all of the residents of our largest city.

Although New York City's fiscal problems are enormous, they come down to this:

The city has been living beyond its means for many years. The cost of the services the City provides has been rising almost twice as fast as the City's capacity to pay for them. The difference between annual income and outgo has been made up in large part by borrowing -- and now the size of New York City's debts are so great that banks are finding it difficult to extend credit to New York City.

But the problem is not new. The New York City fiscal situation was analyzed by a non-partisan State Study Commission for New York City and also by the State Charter Revision Committee for New York City. Both concluded, in effect, that the City's revenue base, big as it is, is simply not large enough to finance all the services that New York City provides.

There is a way out of this dilemma, and I have been pointing to it: Fiscal responsibility, for cities, states, and the Federal government.

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I know how hard it is to reduce or postpone worthy and desirable public programs. Every family who makes up a budget has to make painful choices. As we make these choices at home, so also must we make them in public office too. We must stop promising more and more services without knowing how we will cover their costs.

Above all, it seems to me, we must play fair with the public. The extent to which the Federal Government can or should redistribute revenues among the States and cities is limited by standards of equity. The extent to which States can or should subsidize cities is also limited. And the taxpayer, on whom the whole pyramid rests, can only carry so much. It is fruitless to promise him more than he is willing to pay for.