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[Sept. 1975]

A B I L L

To amend the Bankruptcy Act to add a new chapter thereto providing for the adjustment of the debts of major municipalities.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Bankruptcy Act of 1893 (30 Stat. 544), as amended, is hereby amended to add a new Chapter XVI thereto reading as follows:

CHAPTER XVI - ADJUSTMENT OF INDEBTEDNESSES
OF MAJOR MUNICIPALITIES

JURISDICTION AND RESERVATION OF POWERS

SEC. 801. (a) This Act and proceedings thereunder are found and declared to be within the subject of bankruptcies and, in addition to the jurisdiction otherwise exercised, courts of bankruptcy shall exercise original jurisdiction as provided in this chapter for the composition or extension of the debts of certain public agencies or instrumentalities or political subdivisions. The court in which the petition is filed in accordance with Subsection 804(c) shall exercise exclusive jurisdiction for the adjustment of petitioner's debts and, for purposes of this chapter, shall have exclusive jurisdiction of petitioner and its property, wherever located.

(b) Nothing contained in this chapter shall be construed to limit or impair the power of any State to control by legislation



or otherwise, any public agency or instrumentality or political subdivision of the State in the exercise of its political or governmental powers, including expenditure therefor; Provided, however, that no State law prescribing a method of composition of indebtedness of such agencies shall be binding upon any creditor who does not consent to such composition, and no judgment shall be entered under such State law which would bind a creditor to such composition without his consent.

DEFINITIONS

SEC. 802. The words and phrases used in this chapter have the following meanings unless they are inconsistent with the context.

- (1) The term "attorney" means an attorney licensed to practice law by any State and includes a law partnership.
- (2) The term "claim" means a demand for performance of an obligation to pay money, whether matured or unmatured.
- (3) The term "composition" means a plan for payment of less than the full amount of debts provided for by the plan, with or without the extension of time for payment of such debts.
- (4) The term "court" means United States District Court sitting in bankruptcy, and the terms "clerk" and "judge"

shall mean the clerk and judge of such court.

- (5) The term "creditor" means any person who owns a claim against the petitioner. With respect to such claims owned by a trustee under a mortgage deed of trust, or indenture, pursuant to which there are securities outstanding, other than voting trust certificates, the term "creditor" means only the trustee.
- (6) The term "lien" means a security interest in property, a lien obtained on property by levy, sequestration or other legal or equitable process, a statutory or common-law lien on property, or any other variety of charge against property to secure performance of an obligation.

ELIGIBILITY FOR RELIEF

SEC. 803. (a) Any municipality with a population in excess of 1,000,000 inhabitants is eligible for relief under this chapter, if the municipality is first specifically authorized by the State to file a petition initiating a proceeding under this chapter.

(b) Any public agency or instrumentality or political subdivision subordinate to such municipality or whose responsibilities are restricted to the geographical limits thereof, including incorporated authorities, commissions and districts, for whose debts such municipality is not otherwise liable, is eligible for relief as a separate petitioner in the same proceeding in which such municipality seeks relief under this chapter if such agency, instrumentality or subdivision is not prohibited from filing a petition by applicable State law.

PETITION; PROPOSED PLAN AND STATEMENT OF

REVENUES AND EXPENDITURES; FILING

SEC. 804. (a) Any entity eligible for relief under Section 803 may file a voluntary petition under this chapter. The petition shall state that the petitioner is eligible to file a petition, that the petitioner is insolvent or unable to pay its debts as they mature and that it desires to effect a plan of composition or extension of its debts. The petitioner shall file with its petition lists of claims outstanding and of persons who may be adversely affected by the plan, as set forth in Section 809.

(b) A petition shall be insufficient to invoke the jurisdiction of the court unless it is accompanied by (1) a good faith plan of



composition or extension of debts which petitioner certifies is in its view fair, equitable, feasible, and not unfairly discriminatory in favor of any creditor or class of creditors and (2) a statement of petitioner's current and projected revenues and expenditures adequate to establish that the budget of petitioner will be in balance within a reasonable time after adoption of the plan.

(c) The petition shall be filed with the court in whose territorial jurisdiction the municipality or the major part thereof is located, and shall be accompanied by payment to the clerk of a filing fee of \$100, which shall be in lieu of the fee required to be collected by the clerk under other applicable chapters of this title, as amended.

STAY OF PROCEEDINGS

SEC. 805. (a) A petition filed under Section 804 shall operate as a stay of the commencement or the continuation of any court or other proceeding against the petitioner, its property or any officer or inhabitant of the petitioner, which seeks to enforce any claim against the petitioner; as a stay of any act or the commencement or continuation of any court proceeding to enforce any lien on taxes or assessments, or to reach any property of the petitioner; and as a stay of the application of any set-off or enforcement of any

counterclaim relating to any contract, debt or obligation of the petitioner.

(b) Except as it may be terminated, annulled, modified, or conditioned by the court under Subsection (c) of this Section, the stay provided by Subsection (a) of this Section shall continue until the case is closed or dismissed or the property subject to the lien is, with the approval of the court, abandoned or transferred.

(c) On the filing of a motion seeking relief from a stay provided by Subsection (a) of this Section, the court shall set a hearing for the earliest possible date. The court may, for cause shown, terminate, annul, modify or condition such stay.

(d) The commencement or continuation of any act or proceeding other than described in Subsection (a) of this Section may be stayed, restrained, or enjoined pursuant to Rule 65 of the Federal Rules of Civil Procedure, except that a temporary restraining order or preliminary injunction may be issued without compliance with subdivision (c) of that rule.

(e) No stay, order, or decree of the court may interfere with
(1) any of the political or governmental powers of the petitioner;



or (2) any of the property or revenues of the petitioner necessary for essential governmental purposes; or (3) the petitioner's use or enjoyment of any income-producing property. Provided, however, that the court shall enforce the conditions attached to certificates of indebtedness issued under Subsection 811 and the provisions of the plan of compensation.

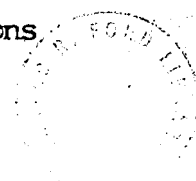
CONTEST AND DISMISSAL OF PETITION

SEC. 806. (a) Any creditor may file a complaint in the bankruptcy court contesting the petition for relief under this chapter or stating any objection he has to the plan. The complaint may be filed at any time up to ten days before the hearing on the confirmation of the plan or within such other times as may be directed by the court.

(b) The court may, upon notice to the creditors and a hearing following the filing of such a complaint, dismiss the proceeding if it finds that the petition was not filed in good faith, that it does not meet the provisions of this chapter, that it has not been prosecuted with reasonable diligence, or that there is no substantial likelihood that a plan of composition will be approved by the court.

NOTICES

SEC. 807. (a) The clerk shall give prompt notice of the commencement of a proceeding under this chapter to the State and to the Securities and Exchange Commission. As creditors and other persons



who may be materially and adversely affected by the plan are identified, the clerk shall give such persons notice of the commencement of the proceeding, a summary of the provisions of the plan and any proposed modification of the plan, and of their right to request a copy of the plan, or modification.

(b) The clerk shall also give notice to all creditors of the time permitted for accepting or rejecting a plan or any modification thereof. Such time shall be 90 days from the filing of the plan or modification unless the court for good cause shall set some other time.

(c) The clerk shall also give notice to all creditors (1) of the time permitted for filing a complaint objecting to confirmation of a plan, (2) of the date set for hearing objections to such complaint, (3) of the date of hearing of a complaint seeking dismissal of the petition, and (4) of the date of the hearing on confirmation of the plan.

(d) All notices given by the clerk shall be given in the manner directed by the court; however, the court may issue an order at any time subsequent to the first notice to creditors directing that those persons desiring written notice file a request with the court. If the court enters such an order persons not so requesting will receive no further written notice of proceedings under the chapter.

(e) Cost of notice shall be borne by the petitioner, unless the court for good cause determines that the cost of notice in a particular instance should be borne by another party.



REPRESENTATION OF CREDITORS

SEC. 808. For all purposes of this chapter any creditor may act in person or by an attorney or a duly authorized agent or committee. Where any committee, organization, group, or individual shall assume to act for or on behalf of creditors, such committee, organization, group, or individual shall first file with the court in which the proceeding is pending a list of the creditors represented, giving the name and address of each and describing the amount and character of the claim of each; copies of the instrument or instruments in writing signed by such creditors conferring the authority for representation; and a copy of the contract or contracts of agreement entered into between such committee, organization, group, or individual and the represented creditors, which contract or contracts shall disclose all compensation to be received, directly or indirectly for such representation, which agreed compensation shall be subject to modification and approval by the court.

LIST OF CLAIMS AND PERSONS ADVERSELY AFFECTED

SEC. 809. (a) The list of claims filed with the petition shall include, to the extent practicable, the name of each known creditor to be affected by the plan, his address so far as known to the petitioner, and a description of each claim showing its amount and character, the nature of any security therefor and whether the claim is disputed,



contingent or unliquidated as to amount. With respect to creditors not identified, the petition shall set forth the reasons identification is not practicable, and shall specify the character of claim involved. The list shall be supplemented as petitioner becomes able to identify additional creditors.

(b) If the proposed plan requires revision of assessments so that the proportion of special assessments or special taxes to be assessed against some real property will be different from the proportion in effect at the date the petition is filed, the holders of record of title, legal or equitable, to such real property shall be deemed persons adversely affected and shall be similarly listed.

(c) The court may for cause modify the requirements of Subsections (b) and (c) of this Section.

PROOFS OF CLAIM

SEC. 810. Unless an objection is made by any party in interest, the claim of a creditor that is not disputed, is established by the list of claims filed pursuant to Section 809. The court may set a date by which proofs of claim of unlisted creditors and of creditors whose listed claims are disputed must be filed. If the court does not set such a date, the proofs must be filed before the entry of the order of confirmation. The clerk shall give notice to each person whose claim is listed as disputed in the manner directed by the court.



DEBT CERTIFICATES

SEC. 811. During the pendency of a proceeding for a plan of composition or extension under this chapter, or after the confirmation of the plan if the court has retained jurisdiction, the court may, upon good cause shown, authorize the petitioner to issue certificates of indebtedness for cash, property or other consideration, under such terms and conditions and with such security and priority in payment over existing obligations as the court may approve. Notwithstanding any other provision of law including Section 819 of this chapter, the court shall have plenary jurisdiction of any action which may be brought against petitioner to enforce compliance with the terms of any such certificates of indebtedness.

PRIORITIES

SEC. 812. The following shall be paid in full in advance of the payment of any distribution to creditors under a plan, in the following order:

- (1) The cost and expenses of administration which are incurred by the petitioner subsequent to the filing of a petition under this chapter.
- (2) Debts owed for services and materials actually provided within four months before the date of the filing of the petition under this chapter.



- (3) Debts owing to any person or entity, which by the laws of the United States (other than this Act) are entitled to priority.

PLAN OF ADJUSTMENT

SEC. 813. The plan of composition or extension sought under this chapter may include provisions modifying or altering the right of creditors generally, or of any class of them, secured or unsecured, either through issuance of new securities of any character, or otherwise, and may contain such other provisions and agreements not inconsistent with this chapter as the parties may desire, including provisions for the rejection of executory contracts and unexpired leases.

VOTING ON ACCEPTANCE OF PLAN

SEC. 814. (a) A plan of composition or extension may be confirmed only if, of the creditors voting in writing to accept or reject the plan, those holding two-thirds in amount of each class materially and adversely affected have voted to accept: Provided, however, that no such acceptance shall be required from any class which, under the plan, is to be paid in cash the value of its claims or is to be afforded such method of protection as will, consistent with the circumstances of the particular case, equitably and fairly provide for the realization of the value of its claims.



(b) Unless his claim has been disallowed, any creditor who is included on the list filed pursuant to Section 809 or who files a proof of claim pursuant to Section 810 is entitled to vote to accept or reject a plan or modification thereof within the time set pursuant to Subsection 807(b). Claims owned, held or controlled by the petitioner are not eligible to vote.

(c) The holders of all claims regardless of the manner in which they are evidenced, which are payable without preference out of funds derived from the same source or sources shall be of one class. The holders of claims for the payment of which specific property or revenues are pledged, or which are otherwise given preference as provided by law, shall constitute a separate class or classes of creditors.

(d) If any controversy shall arise as to whether any creditor or class of creditors shall or shall not be materially and adversely affected, the issue shall be determined by the judge, after hearing, upon notice to the parties interested.

MODIFICATION OF PLAN

SEC. 815. Before a plan is confirmed, changes and modifications may be made therein with the approval of the judge after hearing and upon such notice to creditors as the judge may direct, subject to the right of any creditor who has previously accepted the plan to withdraw his acceptance in writing, within a period to be fixed by the



judge, if, in the opinion of the judge, the change or modification will materially and adversely affect such creditor; and if any creditor having such right of withdrawal shall not withdraw within such period, he shall be deemed to have accepted the plan as changed or modified: Provided, however, That the plan as changed or modified shall comply with all the provisions of this chapter and shall have been accepted in writing by the petitioner.

HEARING ON CONFIRMATION OF PLAN

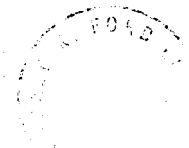
SEC. 816. (a) Within a reasonable time after the expiration of the time within which a plan and any modifications thereof may be accepted or rejected, the court shall set a hearing on the confirmation of the plan and modifications, and the clerk shall give notice of the hearing and time allowed for filing objections as provided in Subsection 807(c).

(b) Any creditor, or any other party in interest may file a complaint objecting to the confirmation of the plan. The complaint shall be served on the petitioner, and such other persons as may be designated by the court, at any time prior to the date of the hearing on confirmation or such earlier date as the court may set.

(c) Before concluding the hearing on confirmation of the plan the judge shall inquire whether any person promoting the plan or doing anything of such a nature, has been or is to be compensated, directly or indirectly, by both the petitioner and any creditor, and shall take evidence under oath to ascertain whether any such practice obtains. After such examination the judge shall make an

adjudication of this issue, and if he finds that any such practice obtains, he shall forthwith dismiss the proceeding and tax all of the costs against such person, or against the petitioner, unless such plan be modified within the time to be allowed by the judge so as to eliminate the possibility of any such practice.

(d) At the conclusion of the hearing, the judge shall make written findings of fact and his conclusions of law thereon, and shall enter a decree confirming the plan if he finds and is satisfied that (1) it is fair, equitable, feasible and not unfairly discriminatory in favor of any creditor or class of creditors; (2) it complies with the provisions of this chapter; (3) it has been accepted by creditors as required in Section 814; (4) all amounts to be paid by the petitioner for services or expenses incident to the composition have been fully disclosed and are reasonable; (5) the offer of the plan and its acceptance are in good faith; (6) the petitioner is authorized by law to take all action necessary to be taken by it to carry out the plan; and (7) it appears from petitioner's current and projected revenues and expenditures that the budget of the petitioner will be in balance within a reasonable time after adoption of the plan. If not so satisfied, the judge shall enter an order dismissing the proceeding. No case shall be reversed or remanded for want of specific or detailed findings unless it is found that the evidence is insufficient to support one or more of the general findings required in this section.



EFFECT OF CONFIRMATION

SEC. 817. (a) The provision of a confirmed plan shall be binding on the petitioner and on all creditors, whether or not they are affected by it, whether or not their claims have been listed, filed, or allowed, and whether or not they have accepted the plan.

(b) The confirmation of a plan shall extinguish all claims against the petitioner provided for by the plan other than those excepted from discharge by the plan or order confirming the plan.

DUTY OF PETITIONER AND DISTRIBUTION UNDER PLAN

SEC. 818. (a) The petitioner shall comply with the provisions of the plan and the orders of the court relative thereto and shall take all actions necessary to carry out the plan.

(b) Subject to the provisions of Subsection (c), distribution shall be made in accordance with the provisions of the plan to creditors (1) whose proofs of claim have been filed and allowed or (2) whose claims have been listed and are not disputed. Distribution to creditors holding securities of record shall be made to the record holders as of the date the order confirming the plan becomes final.

(c) When a plan requires presentment or surrender of securities or the performance of any other act as a condition to participation under the plan, such action must be taken not later than five years after the entry of the order of confirmation. Persons who have not within such time presented or surrendered their securities or taken



such other action shall not participate in the distribution under the plan. Any securities, monies, or other property remaining unclaimed at the expiration of the time allowed for presentment or surrender of securities or the performance of any other act as a condition to participation in the distribution under a confirmed plan shall become the property of the petitioner.

(d) The court may direct the petitioner and other necessary parties to execute and deliver or to join in the execution and delivery of any instruments required to effect a transfer of property pursuant to the confirmed plan and to perform such other acts, including the satisfaction of liens, as the court may determine to be necessary for the consummation of the plan.

RETENTION OF JURISDICTION

SEC. 819. The court may retain jurisdiction of a proceeding under this chapter for such period as it determines is necessary to assure execution of the plan.

REFERENCE OF ISSUES AND COMPENSATION

SEC. 820. (a) The judge may refer any special issues of fact to a referee in bankruptcy, magistrate or another special master for consideration, the taking of testimony, and a report upon such special issues of fact, if the judge finds that the condition of his docket is such that he cannot take such testimony without unduly delaying the dispatch of other business pending in his court, and if



it appears that such special issues are necessary to the determination of the case. Only under special circumstances shall reference be made to a special master who is not a referee in bankruptcy or a magistrate. A general reference of the case to a master shall not be made, but the reference, if any, shall be only in the form of requests for findings of specific facts.

(b) The court may allow reasonable compensation for the services performed by any such special master who is not a salaried Federal employee, and the actual and necessary expenses incurred in connection with the proceeding, including compensation for services rendered and expenses incurred in obtaining the deposit of securities and the preparation of the plan, whether such work may have been done by the petitioner or by committees or other representatives of creditors, and may allow reasonable compensation for the attorneys or agents of any of the foregoing: Provided, however, That no fees, compensation, reimbursement, or other allowances for attorneys, agents, committees, or other representatives of creditors shall be assessed against the petitioner or paid from any revenues, property, or funds of the petitioner except in the manner and in such sums, if any, as may be provided for in the plan of adjustment. An appeal may be taken from any order making such determination or award to the United States Court of Appeals for the circuit in which the proceeding under this chapter is pending, independently of other appeals which may be taken in the proceeding, and such appeal shall be heard summarily.



SEPARABILITY

SEC. 821. If any provision of this chapter, or the application thereof to any agency, instrumentality, or subdivision is held invalid, the remainder of the chapter, or the application of such provision to any other agency or instrumentality or political subdivision shall not be affected by such holding.



THE WHITE HOUSE

WASHINGTON

September 2, 1975

File
NY City

MEMORANDUM FOR: MAX L. FRIEDERSDORF
FROM: WILLIAM T. KENDALL
SUBJECT: Senator Javits' telephone call

The Senator had a talk with the President last week regarding New York's troubles and he urged the President to say something appropriate at the proper time without promising anything. The Senator thinks the time has arrived.

Next Friday morning there will be a kickoff meeting of a citizens committee which is being sponsored by both Javits and Buckley. He thinks it would be good if the President could send a message to the group something along the following line:

"I have been advised that you are forming a citizens group in order to help solve New York City's financial problems. I have always believed that a maximum of self-help is desirable and I am pleased to see that the citizens of New York are organizing for this purpose. I can assure you that we at the Federal level are not oblivious to your efforts and wish you well in your search for a solution to the problems facing the city."



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PMS HON ROCKEFELLER, VICE PRESIDENT, THE UNITED STATES

EXECUTIVE BUILDING

WASHINGTON DC 20013

ON BEHALF OF THE NEW YORK STATE AFL-CIO I RESPECTFULLY URGE YOU
TO INTENSIFY YOUR EFFORTS ON THE FEDERAL LEVEL TO ALLEVIATE THE
DEVASTATING IMPACT OF NEW YORK CITY'S FINANCIAL CRISIS AND ASSURE
FEDERAL ASSISTANCE AND FEDERAL GUARANTEE OF THE M.A.C. BONDS.

THE FEDERAL GOVERNMENT IS DEEPLY INVOLVED IN A VAST SUBSIDY PROGRAM
IN THE FORM OF DIRECT GRANTS TO BUSINESS FIRMS AND CORPORATIONS,
AGRICULTURAL SUBSIDIES, TAX BENEFITS TO SPECIFIC ECONOMIC GROUPS,
LENDING AND LOAN GUARANTEE PROGRAMS OF VARIOUS FEDERAL AGENCIES,
AND LAST BUT NOT LEAST, DIRECT BENEFITS TO COMMERCIAL BANKS. THE
LATTER ARE BENEFICIARIES OF A WINDFALL SUBSIDIZATION BY THE FEDERAL

SF-1201 (R5-69)

GOVERNMENT THAT DEPOSITS LARGE AMOUNTS OF THE TAXPAYER'S MONEY WITH-
OUT RECEIVING FAIR COMPENSATION. WE FIND IT SHOCKING THAT THE
FEDERAL ADMINISTRATION SHOWS ITS CALLOUS INDIFFERENCE TO THE NEW
YORK CITY CRISIS WHILE ALLOWING SOME FIFTY COMMERCIAL BANKS NOT TO
PAY ANY INTEREST TO THE GOVERNMENT BUT TO REAP HIGH RATES OF INTEREST

NOT FOR THE BENEFIT OF THE TAXPAYERS, BUT FOR THEMSELVES AND THEIR
STOCKHOLDERS. IF INTEREST HAD BEEN PAID ON THE DEPOSITED AMOUNTS,
THE U.S. GOVERNMENT WOULD HAVE RECEIVED ANNUALLY \$350 TO \$400
MILLION, ENOUGH TO STAVE OFF AT LEAST FOR THE NEXT FEW WEEKS THE
FINANCIAL CRISIS OF THE CITY. UNDER THESE CIRCUMSTANCES, FAIRNESS
AND JUSTICE REQUIRE FEDERAL HELP FOR A CITY FALLEN UPON THE WORST
CRISIS IN ITS HISTORY

RAYMOND R CORBETT PRESIDENT

SF-1201 (R5-69)



ny city

nyc

SUBJ/PERSONAL FILE
FORD, GERALD R.

*Both Dubois
This is Buckle's
proposal for nyc.*



September 17, 1975

The Honorable Gerald R. Ford
The White House
Washington, D.C. 20500

Dear Mr. President:

The grave fiscal situation in New York City has given rise to substantial fears that any default by the City on its indebtedness could so damage investor confidence in municipal securities that it would become difficult and unduly expensive for other cities in New York State, and elsewhere in the United States, to do necessary financing irrespective of their own credit ratings. If these fears are well-founded, we clearly face a potential danger of national proportions that can best be met by some form of insurance.

The problem with designing a specific plan for insuring municipal securities is to devise one that will require appropriate standards of fiscal management from insured municipalities while at the same time avoiding a further intrusion by Washington into the affairs of local governments.

I would like to propose, for your study and consideration, a concept that has been overlooked in the discussion of the problems of municipal financing that has resulted from the crisis in New York City; and that is the concept of federal re-insurance limited to short-term municipal obligations.



Simply stated, this concept would work through

existing private insurance companies which currently insure the payment of municipal debt and interest on that debt. It contemplates the formation, with federal sponsorship and support, of a re-insurance organization which would, in effect, insure the insurance companies against losses incurred from municipal defaults over and above some reasonable figure (say, \$20 million).

Under such an approach, municipal governments seeking to have their obligations insured would have to satisfy the private insurance organizations that their fiscal houses and management are in sufficiently good order to warrant assuming the substantial risk that would not be covered by the federally-sponsored re-insurance program. This would create incentives to municipalities to maintain standards that render their notes insurable without placing the federal government in the position of setting those standards.

The availability of re-insurance would guarantee that soundly-run municipalities will have access to financing. The premiums that municipalities would have to pay in order to secure insurance would, of course, add to the cost of financing. This added cost, however, would to a degree be offset by the lower interest rates that insured securities would command.

I hope you will give this program your careful thought and study. I deeply hope that the measures adopted by New York State and a determination by the officials of New York City to reduce costs to an absolute minimum will result in avoiding a default on the City's obligations. That there may be such a default is, however, a possibility that cannot be ignored. This suggests that study of any program that would facilitate the financing of short-term municipal obligations should be undertaken immediately.

JLB:dc

Yours respectfully,



Determined to be Administrative Marking
Date 5/4/81 By DNA

MEMORANDUM

September 23, 1975

CONFIDENTIAL

SUBJECT: New York City - For Your Information

Three things in regard to the New York City financial problem will happen tomorrow.

1. Republican Leadership Breakfast: Barber Conable will raise the political implications of the Administration's present posture.

The basis for his argument comes from the attached memo to him that Warren Anderson prepared. (Tab A)

2. Secretary Simon testifies before Senator Humphrey tomorrow.

The latest draft of his testimony that I have is attached at Tab B.

It is in my opinion somewhat more sympathetic than heretofore and does not now give the impression that default of the City is the only possible outcome.

3. The President is meeting with a group from the Conference of Mayors who will say something like:
 - a) New York City's problems will soon be ours.
 - b) We need an RFC type authority to assist in the banking of all municipal securities.

Comment

The key questions are:

1. What will be the effect of a New York City default on the City and other municipal securities.



2. Can a New York City default be contained, such as
 - a) New York State authorities
 - b) New York State securities
 - c) Other weak municipals.

There is no answer, of course, because nobody knows, nothing of this magnitude has ever happened.

The Anderson thesis is chaos with nationwide economic and political implications.

Secretary Simon's thesis is that a New York City default has been discounted and can be contained.

This is a tough financial and political decision for the President to make.



THE NEW YORK CITY DEFAULT ISSUE: POLITICAL SIGNIFICANCE

It appears that the Administration may be making a major and potentially fatal miscalculation concerning the political impact upon 1976 of a New York City default.

Undoubtedly, the "tough-minded" approach of teaching a hard lesson to mismanaged, profligate New York City strikes a responsive chord among many people in the rest of the country. But this response may well be short lived should default by the City actually occur.

Despite protestations by Administration spokesmen and others to the effect that the markets have already discounted the effects of a default, and that the impacts of default can be contained, the fact is that there has never been a default of the magnitude of that now threatened, and the consequences simply cannot be predicted.

There is a substantial danger that a New York City default will have a domino effect. It is already causing a clear threat of default to the nation's second-largest issuer of municipal obligations, the New York State Housing Finance Agency. Should New York City and NHA default, New York State itself would probably not be far behind.

With a major portion of the national total of municipal obligations in default, there is an excellent chance that the national municipal market would simply collapse. Even if that market did not totally collapse, the likely impacts would be far-reaching, not only within the borders of New York State, but also upon large

urban centers and upon the banking system throughout the nation.

The finance director of Philadelphia has already stated that New York City's problems are driving his city out of the market. The State of Massachusetts was recently forced to place the full faith and credit of the State behind its Housing Finance Agency in order to prevent a default. The State of Washington's Public Power system this week was forced to accept an average net interest cost of 7.72% on a bond issue -- rated AAA and guaranteed by a Federal agency!

The most recent municipal Bond Buyer index stands at 7.81, another all-time high -- and this index does not include New York City obligations.

The potential impact of an actual default by New York City upon other large cities and their states is immense. Beyond New York State, the viability of Pennsylvania, Massachusetts, Michigan, California, Missouri, Illinois, Ohio and New Jersey would almost certainly be jeopardized. Putting New York State aside, which provided a 1.2 million Republican plurality in 1972, the political impacts upon 1976 of severe dysfunction in such states would be substantial. In 1968, when President Nixon won by a margin of 110 electoral votes, California, Illinois, New Jersey, Missouri and Ohio alone provided him a total of 121 electoral votes.

Further, the impact of a New York City default upon the nation's banking system could be horrendous. As of June 30, 1975, the nation's 100 largest commercial banks held \$30 billion in state and municipal obligations. It is certainly doubtful that the



Federal Reserve discount window could open widely enough to handle the sort of panic of such magnitude that could ensue. The largest single holder of such obligations was the Bank of America, with \$2,069,000,000, or 3.2% of its total assets. New York, Chicago and San Francisco banks have large positions in municipal obligations, but as a general rule banks outside of these three sophisticated banking centers have relatively far larger proportions of their assets invested in municipal obligations.

As of June 30, 1975, the Detroit Bank and Trust Company's \$461,000,000 in municipal obligations represented 15.52% of its total assets.

The First National Bank of Dallas' \$441,000,000 represented 15.82%.

Cleveland Trust's \$610,000,000 represented 16.53%.

The Wachovia Bank and Trust's (Winston-Salem) \$498,000,000 represented 15.47%.

The Maryland National Bank's \$299,000,000 represented 13.37%.

"Containment" under such circumstances is difficult to conceive.

Thus, a New York City default could bring down New York State and other large cities and states, destroy the municipal market generally, and create a veritable panic throughout the nation's banking system. It could bring about a national catastrophe.

The impacts upon the Administration and national economic recovery could be tremendous.

State and local construction programs — crucial to the

Republican-oriented building trade unions and construction industry — could be terminated.

Legitimate short-term borrowing by states and municipalities necessary to cover their day-to-day expenses could be precluded, with consequent chaos and conflagration particularly in urban areas.

The nation's banking system could be plunged into disarray, with catastrophic results intensified by the huge need for Federal financing of its current deficit as well as private capital to fuel recovery.

Demands upon the Federal treasury for relief from the people, the jobless, the banks, etc., could be inexorable and beyond its capability.

Recession could become depression and inflation exacerbated.

With such terrible consequences possible, a gamble that the impact of a New York City default has been "discounted" and can be "contained" seems to be a very bad one.

It appears evident that at the very least, a significant national impact of a New York City default is unavoidable while a New York City default is at this moment still avoidable.

Failure by the Administration to help avoid such a default and its almost certain consequences could provide the Democrats with their most telling political issue for 1976 — involving as it would states whose electoral support has been and will be crucial, and the gut problem of jobs and recession.

Conceivably, Hugh Carey -- combining a populist and Catholic appeal and already attracting Kennedy loyalists -- could be elevated to the status of an unbeatable opponent with one all-encompassing issue.

The current appeal of appearing to discipline big-city liberal profligacy would prove short-lived as national pocketbook impacts replaced emotional response.

It would seem far better for the Administration to have its cake and eat it too, by proclaiming that since its hard-tough attitude to date has produced the desired, constructive result of forcing the big-spenders to discipline themselves, it is now time to protect the national economic recovery and the good people of the other urban centers from the possible consequences of New York City's past misdeeds by helping to prevent its default. Limited guarantees or loans, cash-flow assistance, a national insurance program -- all or some could be proposed to prevent the default at minimal direct cost.

The alternative is to risk certain failure in 1976 -- certainly the stakes are unnecessarily high.

TAB B

FOURTH DRAFT

9/21/75

FOR RELEASE ON DELIVERY

STATEMENT OF THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
BEFORE THE JOINT ECONOMIC COMMITTEE
WEDNESDAY, SEPTEMBER 24, 1975, 11:00 A.M.

NEW YORK CITY'S FINANCIAL SITUATION

MR. CHAIRMAN AND MEMBERS OF THIS DISTINGUISHED COMMITTEE:

I AM HERE TODAY AT THE EXPRESS INVITATION OF THE
CHAIRMAN, WHO HAS CALLED UPON ME TO TESTIFY ABOUT THE POSSIBLE
IMPACT OF A FINANCIAL DEFAULT BY NEW YORK CITY..

THIS IS AN OCCASION THAT NONE OF US CAN WELCOME. ALL OF
US SHARE THE HOPE THAT A DEFAULT CAN BE AVOIDED. PERSONALLY,
I AM CONFIDENT THAT IF THE PROPER STEPS ARE TAKEN, DEFAULT
WILL BE AVOIDED. ONE OF THE GREAT PLEASURES IN MY LIFE WAS
TO SPEND SOME 20 YEARS WORKING IN THE FINANCIAL COMMUNITY IN



DOWNTOWN MANHATTAN. I GAINED FROM THAT EXPERIENCE--NOT ONLY A LOVE FOR THE CITY BUT ALSO ENORMOUS RESPECT FOR THE WISDOM AND STRENGTH OF ITS PEOPLE. I SINCERELY BELIEVE THAT IF THOSE GREAT RESOURCES ARE PROPERLY MARSHALED, NEW YORK CITY WILL EMERGE FROM ITS CURRENT DIFFICULTIES.

AS YOUR INVITATION TO ME RECOGNIZES, HOWEVER, IT IS ALSO IMPORTANT THAT WE SEEK TO UNDERSTAND WHAT THE IMPLICATIONS WOULD BE IF DEFAULT DOES OCCUR. I AM SURE THAT THE MEMBERS OF THIS COMMITTEE, AS WELL AS THE AMERICAN PEOPLE, WANT THIS INQUIRY TO BE AS HONEST AND OBJECTIVE AS POSSIBLE. THIS CANNOT BE A TIME WHEN WE DELUDE OURSELVES WITH EXCESSIVE OPTIMISM AND THUS FAIL TO ACT WISELY. BY THE SAME TOKEN, WE SHOULD NOT ENGAGE IN EXCESSIVE PESSIMISM. IMPASSIONED STATEMENTS THAT A DEFAULT WOULD HAVE CATASTROPHIC CONSEQUENCES FOR THE FINANCIAL MARKETS AS WELL AS THE ECONOMY -- STATEMENTS WHICH HAVE NO FOUNDATION IN OBSERVABLE FACTS -- CAN ONLY MAKE



THE SITUATION WORSE. THIS IS A TIME, THEN, FOR AN HONEST APPRAISAL, DEVOID OF EMOTIONALISM OR PARTISANSHIP. MY TESTIMONY TODAY IS OFFERED IN THAT SPIRIT.

THE FEDERAL GOVERNMENT HAS BEEN SERIOUSLY CONCERNED WITH THE PROBLEMS ASSOCIATED WITH NEW YORK CITY'S FINANCES FOR A LONG WHILE. WE HAVE HELD REPEATED MEETINGS WITH THE LEADERS OF NEW YORK CITY, THE MUNICIPAL ASSISTANCE CORPORATION, AND NEW YORK STATE. A CONSIDERABLE AMOUNT OF STAFF TIME WITHIN THE TREASURY DEPARTMENT HAS BEEN DEVOTED TO THIS MATTER. AT THE PRESIDENT'S DIRECTION, I HAVE ESTABLISHED AN INFORMAL, INTER-AGENCY TASK FORCE, CHAIRED BY MY UNDER SECRETARY EDWIN H. YEO III, TO CLOSELY MONITOR THIS SITUATION ON A DAILY BASIS AND TO DEAL WITH EVERY ASPECT OF A POTENTIAL DEFAULT BY THE CITY. THE EVALUATIONS AND THE PLANS OUTLINED IN MY TESTIMONY THIS MORNING ARE THE PRODUCT OF THOSE EFFORTS.



OUR BASIC CONCLUSIONS, WHICH I SHALL EXPAND UPON IN A FEW MOMENTS, ARE THESE:

FIRST, ALTHOUGH THE CHALLENGES AND THE TASKS AHEAD ARE GREAT, NEW YORK CITY, WITH THE ASSISTANCE OF NEW YORK STATE, HAS BOTH THE MECHANISMS AND THE RESOURCES TO AVOID DEFAULT.

SECOND, IF DEFAULT WERE TO OCCUR DESPITE THEIR BEST EFFORTS, ITS EFFECTS WOULD PRIMARILY BE LEGAL IN CHARACTER: THE BASIC SERVICES OF THE CITY SHOULD REMAIN INTACT.

THIRD, WHILE A DEFAULT COULD ADVERSELY AFFECT THE CAPITAL MARKETS, THOSE MARKETS HAVE ALREADY ADJUSTED TO THAT POSSIBILITY TO SOME EXTENT AND THE EVENT OF DEFAULT WOULD REQUIRE ONLY A MODERATE DEGREE OF FURTHER ADJUSTMENT.

IN OTHER WORDS, THE EFFECTS OF DEFAULT UPON THE CAPITAL MARKETS WOULD BE TOLERABLE.

FOURTH, A DEFAULT WOULD CAUSE LITTLE, IF ANY, DAMAGE



TO OUR OVERALL FINANCIAL STRUCTURE: THE BANKING SYSTEM WOULD REMAIN INTACT; NO BANK CUSTOMERS WOULD LOSE THEIR DEPOSITS; AND THE SYSTEM WOULD CONTINUE TO BE ABLE TO PROVIDE CREDIT TO ALL LEVELS OF THE ECONOMY, INCLUDING CONSUMERS.

FIFTH, THE COSTS AND RISKS ASSOCIATED WITH ANY PROGRAM TO PROVIDE SPECIAL FEDERAL FINANCIAL ASSISTANCE TO PREVENT DEFAULT SUBSTANTIALLY OUTWEIGH THE BENEFITS.

FINALLY, WE BELIEVE THAT THE FEDERAL GOVERNMENT DOES HAVE A RESPONSIBILITY TO THE NATION TO ENSURE THAT IF A DEFAULT DOES OCCUR, PROPER STEPS ARE TAKEN TO LIMIT AND CONTAIN ITS IMPACT. TOWARD THAT END, WE HAVE DEVELOPED A PROGRAM WITHIN THE ADMINISTRATION. DEVELOPMENT OF THAT PLAN SHOULD NOT BE MISUNDERSTOOD AS AN ANTICIPATION OF DEFAULT; RATHER, IT IS A STANDBY MECHANISM WHICH PRUDENCE SURELY DEMANDS. WHILE MY TESTIMONY WILL DEAL IN MORE DEPTH WITH ITS DETAILS, LET ME SUMMARIZE THAT PROGRAM NOW:



-- TO INSURE ADEQUATE FINANCIAL RESOURCES
TO MAINTAIN ESSENTIAL SERVICES AND TO AVOID
POTENTIAL DISRUPTION AND CONFUSION CREATED
BY CONFLICTING LITIGATION, WE HAVE PRE-
PARED, AND WILL SHORTLY SUBMIT TO THE
CONGRESS, LEGISLATION AMENDING CHAPTER 9
OF THE FEDERAL BANKRUPTCY ACT TO FACILITATE
USE OF THAT ACT'S PROTECTION BY NEW YORK
CITY.

-- TO ASSURE THE CONTINUED FLOW OF CURRENT
ASSISTANCE PAYMENTS, WE HAVE IDENTIFIED
ALTERNATIVE METHODS OF OPERATING THOSE



PROGRAMS IN THE EVENT LOCAL RESOURCES
TEMPORARILY BECOME UNAVAILABLE.

-- TO PROTECT THE BANKING SYSTEM AND THUS
ASSURE THE CONTINUED AVAILABILITY OF RESOURCES
THAT SYSTEM PROVIDES TO CONSUMERS, CORPORATIONS
AND GOVERNMENTS:

-- THE FEDERAL RESERVE SYSTEM WILL
PROVIDE LIQUIDITY THROUGH ITS
DISCOUNT FACILITIES IN THE EVENT
ANY INSTITUTION FACES UNEXPECTED
CASH WITHDRAWALS;



-- AS A LAST RESORT, IN APPROPRIATE CASES,
THE FEDERAL DEPOSIT INSURANCE CORPORATION
WILL PROVIDE CAPITAL TO INSTITUTIONS WHERE
SUCH ACTION IS NECESSARY TO MAINTAIN
SOLVENCY.

LET ME REPEAT, WE DO NOT BELIEVE DEFAULT IS INEVITABLE
AND WE BELIEVE IT ESSENTIAL TO MAKE ALL REASONABLE EFFORTS
TO AVOID DEFAULT. MOREOVER, IF DEFAULT OCCURS, APART FROM
THE BANKRUPTCY AMENDMENT -- WHICH WE BELIEVE TO BE DESIRABLE
IN ANY EVENT -- WE DO NOT EXPECT TO NEED ANY PART OF THIS
PROGRAM. BUT IT IS OUR RESPONSIBILITY -- TO THE CONGRESS
AND TO THE NATION -- TO BE PREPARED FOR ANY EVENTUALITY.

CURRENT STATUS

LET US NOW CONSIDER THE CURRENT EFFORTS OF NEW YORK CITY
AND NEW YORK STATE TO PREVENT A DEFAULT.



ON SEPTEMBER 9, A SPECIAL SESSION OF THE
NEW YORK STATE LEGISLATURE ENACTED LEGISLATION CALLING FOR

- CREATION OF A STATE DOMINATED EMERGENCY FINANCIAL CONTROL BOARD TO ASSUME PLENARY CONTROL OVER THE CITY'S FINANCES;
- AUTHORITY TO ISSUE \$750 MILLION IN SHORT TERM STATE NOTES, THE PROCEEDS TO BE USED TO PURCHASE MAC BONDS;
- A MANDATE TO STATE AND CITY EMPLOYEE PENSION PLANS TO PURCHASE \$750 MILLION IN MAC BONDS (AND RELIEF FOR THE STATE COMPTROLLER WITH RESPECT TO HIS FIDUCIARY RESPONSIBILITIES REGARDING THESE PLANS);
- AN INCREASE IN MAC'S BORROWING AUTHORITY FROM \$3 BILLION TO \$5 BILLION;
- AUTHORIZATION FOR THE CITY TO FILE A PETITION IN BANKRUPTCY UNDER CHAPTER 9 OF THE FEDERAL BANKRUPTCY ACT.



TWO DAYS LATER, NEW YORK STATE SOLD \$755 MILLION OF SHORT TERM NOTES, INCLUDING \$250 MILLION EARMARKED FOR THE CITY. MAC IS BEGINNING TO RAISE FROM OTHER SOURCES THE \$800 MILLION NECESSARY TO COMPLETE THE \$2.3 BILLION PACKAGE REQUIRED TO FINANCE THE CITY THROUGH DECEMBER 1.

AT THE CITY LEVEL, MEANWHILE, MAYOR BEAME HAS APPOINTED A TOP FINANCIAL EXECUTIVE TO SERVE AS THE CHIEF FINANCIAL OFFICER OF NEW YORK CITY AND TO DEVELOP, BY MID-OCTOBER, AN EXPENSE REDUCTION PLAN TO RETURN THE CITY TO A SOUND FISCAL BASIS. THESE LAUDABLE EFFORTS REFLECT A RENEWED SENSE OF DEDICATION TO ATTACK THE CAUSES OF THE PROBLEMS I DISCUSSED WITH CONGRESSMAN ROSENTHAL'S SUBCOMMITTEE LAST JUNE.

WILL THESE MEASURES WORK? CAN THE CITY DO ENOUGH BETWEEN NOW AND DECEMBER TO RESTORE INVESTOR CONFIDENCE?



SOME HAVE ANSWERED IN THE NEGATIVE, BUT I CANNOT AGREE. I WOULD BE LESS THAN CANDID WITH THIS COMMITTEE IF I SUGGESTED THE TASK WILL BE EASY. I WOULD BE LESS THAN CANDID IF I FAILED TO SAY THAT MORE IN THE WAY OF IMMEDIATE ACTIONS -- IMMEDIATE EXPENSE REDUCTIONS -- IS REQUIRED NOW THAN WOULD HAVE BEEN REQUIRED AT SOME EARLIER TIME. BUT IT WOULD BE EQUALLY UNTRUTHFUL TO SUGGEST THAT THE JOB CANNOT BE DONE. APPROPRIATE MECHANISMS ARE NOW IN PLACE. IT IS ESSENTIAL THAT THEY BE USED PROMPTLY AND WELL.

IMPACT OF A DEFAULT

NECESSARY CONCEPTS

TO SET THE FRAMEWORK FOR MY ANALYSIS OF THE IMPACT OF DEFAULT IT IS IMPORTANT TO DEFINE SOME RELEVANT TERMS AND CONCEPTS. I SENSE THAT THE DIALOGUE CONCERNING THE ISSUE HAS BEEN HAMPERED BY CONFUSION OVER THE MEANING AND IMPORT OF CERTAIN KEY WORDS. FIRST, THERE IS "INSOLVENCY" WHICH, SIMPLY STATED, MEANS THAT A PERSON OR A CITY HAS CURRENT



OBLIGATIONS WHICH EXCEED ITS AVAILABLE FUNDS. "DEFAULT" IS A TECHNICAL LEGAL TERM DESCRIBING A DEBTOR'S REFUSAL OR INABILITY TO PAY A CREDITOR WHO HAS DEMANDED PAYMENT. "BANKRUPTCY" DESCRIBES A LEGAL PROCEEDING -- PROVIDED FOR IN THE CONSTITUTION -- UNDER WHICH AN INSOLVENT PARTY IN DEFAULT TURNS OVER TO A COURT THE JOB OF DECIDING HOW HIS FINANCIAL RESOURCES WILL BE APPORTIONED AMONG CREDITORS.

IN LOOKING AT DEFAULT AND BANKRUPTCY, WE SHOULD ALSO DRAW A DISTINCTION BETWEEN THE OPTIONS AVAILABLE IN THE EVENT OF A CORPORATE DEFAULT AND THOSE AVAILABLE WITH RESPECT TO A MUNICIPAL DEFAULT. IF A CORPORATION DEFAULTS AND IS SUBSEQUENTLY BROUGHT UNDER THE JURISDICTION OF A FEDERAL BANKRUPTCY COURT, ONE OPTION -- ALBEIT OFTEN NOT THE MOST DESIRABLE ONE -- IS LIQUIDATION: THE SALE OF ASSETS TO SATISFY



THE CLAIMS OF CREDITORS AND THE SUBSEQUENT DISAPPEARANCE OF THE CORPORATION AS A CONTINUING ENTITY. BOTH COMMON SENSE AND CONSTITUTIONAL PRINCIPLES PRECLUDE SUCH AN OPTION WITH RESPECT TO MUNICIPAL DEFAULTS.

IN THIS RESPECT, A DEFAULT BY A STATE OR LOCAL GOVERNMENT IS CLOSELY ANALOGOUS TO A DEFAULT BY AN INDIVIDUAL PERSON. IN EITHER CASE, IF A BANKRUPTCY PROCEEDING ENSUES, RESOURCES ESSENTIAL TO THE MAINTENANCE OF LIFE IN THE ONE CASE AND ESSENTIAL SERVICES IN THE OTHER, ARE PROTECTED FROM THE DEMANDS OF CREDITORS.

IT IS IMPORTANT TO RE-EMPHASIZE THIS POINT: IF NEW YORK CITY DEFAULTED, IT WOULD CONTINUE TO EXIST AND TO OPERATE. TAX PAYMENTS, FEDERAL AND STATE ASSISTANCE PAYMENTS AND OTHER SOURCES OF REVENUE WOULD CONTINUE TO FLOW. SCHOOLS AND HOSPITALS WOULD REMAIN OPEN; POLICE, FIRE AND SANITATION SERVICES WOULD BE PROVIDED AND PAID



FOR. EVEN DEBT SERVICE ON THE LONG TERM BONDS WOULD APPEAR TO BE WITHIN THE CITY'S MEANS IN THE EVENT OF DEFAULT.

IN SHORT, IT IS ESSENTIAL NOT TO CONFUSE THE LEGAL AND IDIOMATIC MEANINGS OF THE TERM, BANKRUPTCY. IN COMMON



PARLANCE, WE MAY USE BANKRUPTCY TO DEFINE A CONDITION DEVOID OF SUBSTANCE OR RESOURCES. BY THAT DEFINITION, NEW YORK HAS NOT BEEN, IS NOT NOW, AND WILL NOT BE BANKRUPT.

IF NEW YORK CITY DOES DEFAULT, HOWEVER, TO DEAL WITH ITS CREDITORS IN AN ORDERLY WAY, A PROCEEDING UNDER THE FEDERAL BANKRUPTCY LAWS IS THE MOST APPROPRIATE SOLUTION.

AS I HAVE OFTEN SAID, NO OBSERVER WHO IS ASKED TO PREDICT THE IMPACT OF A DEFAULT CAN DO SO WITH ABSOLUTE CERTITUDE. A DEFAULT LIKE ANY MAJOR FINANCIAL REVERSAL -- HAS TWO ASPECTS: A TANGIBLE, OBJECTIVE ASPECT ON THE ONE HAND AND A PSYCHOLOGICAL ASPECT ON THE OTHER. IT WOULD BE INADEQUATE TO LIMIT THE ANALYSIS TO ONLY ONE OF THESE ASPECTS. AND CONFUSING THE TWO WOULD FURTHER CLOUD OUR EVALUATION OF THE



IMPACT OF DEFAULT. I INDEED, I SENSE THAT SUCH CONEUSION IS IN LARGE PART RESPONSIBLE FOR SOME OF THE MORE EXTREME PREDICTIONS WHICH HAVE BEEN MADE IN RECENT WEEKS.

MOREOVER, AS I CAUTIONED IN MY LETTER OF LAST WEEK, IT IS IMPORTANT TO BE SENSITIVE TO THE RISK THAT THE EVALUATION PROCESS ITSELF MAY AGGRAVATE REACTION TO A DEFAULT. LET US SUPPOSE, FOR EXAMPLE, THAT LEADERS OF MAJOR FINANCIAL INSTITUTIONS CONTEND THAT THEIR INSTITUTIONS AND THE MARKETS IN WHICH THEY FUNCTION WOULD BE DEVASTATED BY A DEFAULT. OBJECTIVE FACTORS NOTWITHSTANDING, SUCH CONTENTIONS WOULD MEASURABLY ENHANCE THE IMPACT OF DEFAULT.

LET ME TURN TO A SECTOR-BY-SECTOR ANALYSIS.



ESSENTIAL SERVICES

IF NEW YORK CITY DEFAULTED ON AN OBLIGATION TO REDEEM A MATURING NOTE ISSUE FOR CASH, A QUESTION OF IMMEDIATE IMPORTANCE IS WHETHER THE CITY COULD CONTINUE TO PROVIDE ESSENTIAL SERVICES: POLICE AND FIRE PROTECTION, SANITATION, MASS TRANSIT, WATER AND SEWERAGE FACILITIES, AND THE LIKE. WE EVALUATED THE OUTLAYS REQUIRED TO PROVIDE THESE SERVICES AGAINST THE CITY'S LEVEL OF RECEIPTS. WHILE, AS I HAVE INDICATED ON EARLIER OCCASIONS, LEVELS OF OUTLAY FOR THESE SERVICES ARE EXTREME IN RELATION TO THE OUTLAYS OF OTHER CITIES, NEW YORK CITY'S REVENUES APPEAR SUFFICIENT TO PROVIDE AN ADEQUATE LEVEL OF SERVICES IN THE EVENT OF DEFAULT.



FEDERAL ASSISTANCE PROGRAMS

ANOTHER POTENTIAL CONCERN RELATES TO CONTINUATION OF THE VARIOUS FEDERAL ASSISTANCE PROGRAMS WHICH BENEFIT THE CITIZENS OF NEW YORK. THE OFFICE OF MANAGEMENT AND BUDGET AND THE DOMESTIC COUNCIL HAVE COMPLETED A SURVEY OF THE MOST IMPORTANT OF THESE PROGRAMS WITH THE OBJECTIVE OF IDENTIFYING METHODS FOR MAINTAINING SCHEDULED ASSISTANCE FLOWS IN THE EVENT LOCAL MECHANISMS TEMPORARILY BECOME UNAVAILABLE. IT IS OUR BELIEF THAT A DEFAULT WOULD NOT MATERIALLY INTERFERE WITH THE PROVISION OF CURRENT ASSISTANCE.

AT THE SAME TIME, THE ADMINISTRATION IS CONDUCTING A REVIEW OF THE ASSISTANCE PROGRAMS WITH THE OBJECTIVE OF MAKING THEM MORE EFFICIENT AND LESS BURDENSOME AT THE



LOCAL AS WELL AS THE FEDERAL LEVEL. I HAVE FREQUENTLY
CRITICIZED THE WELFARE PROGRAMS. THEY ARE TOO EXPENSIVE
AND OFTEN MISS THE TARGET INsofar AS HELP TO THE TRULY
DISADVANTAGED IS CONCERNED. THERE IS NO QUESTION THAT
THESE PROGRAMS IN THEIR CURRENT FORM HAVE ADDED TO
NEW YORK CITY'S FINANCIAL BURDEN.

THE PRESIDENT HAS ASKED VICE PRESIDENT ROCKEFELLER,
AS CHAIRMAN OF THE DOMESTIC COUNCIL, TO CONDUCT A THOROUGH
REVIEW OF ALL OUR ASSISTANCE PROGRAMS AND TO DEVELOP
PROPOSALS FOR REFORM. WHILE THAT REVIEW IS NOT YET COMPLETE,
MY VIEWS ARE WELL KNOWN. I HAVE LONG FAVORED A SIMPLE
PROGRAM OF INCOME MAINTENANCE AS THE LEAST BUREAUCRATIC
AND MOST EFFICIENT APPROACH TO OUR RESPONSIBILITIES IN
THIS AREA.



DEBT ADJUSTMENT

THE REQUIREMENT THAT THE CITY CONTINUE TO PROVIDE AND FINANCE ESSENTIAL SERVICES UNDERSCORES THE IMPORTANCE OF INSURING THAT THERE IS AN ORDERLY MECHANISM FOR ALLOCATING THE CITY'S FINANCIAL RESOURCES AND EFFECTING A RESTRUCTURING OF THE SHORT TERM DEBT. - ABSENT SUCH A MECHANISM, THERE IS THE RISK OF A MULTITUDE OF LAWSUITS, EACH SEEKING A LEGAL INJUNCTION AGAINST THE PAYMENT OF CITY FUNDS TO ONE CLASS OF CREDITOR OR ANOTHER.

IT IS FOR THIS REASON THAT WE HAVE PREPARED, AND WILL SUBMIT SHORTLY TO CONGRESS, LEGISLATION AMENDING CHAPTER 9 OF THE FEDERAL BANKRUPTCY ACT. THIS LEGISLATION IS DESIGNED TO INSURE THAT THE CLAIMS OF ALL LEGITIMATE CREDITORS WOULD BE DEALT WITH IN A SINGLE PROCEEDING. IT WOULD BE COMPLEMENTARY TO THE LEGISLATION ENACTED BY THE NEW YORK STATE LEGISLATURE AUTHORIZING NEW YORK CITY, IN THE EVENT OF DEFAULT, TO SEEK REORGANIZATION OF ITS DEBT UNDER THE PLENARY JURISDICTION OF A FEDERAL COURT.



SPECIFICALLY, OUR PROPOSAL WOULD MODIFY EXISTING LAW BY ELIMINATING THE EXISTING REQUIREMENT THAT A CITY MUST FILE A REORGANIZATION PLAN AND WRITTEN ASSENTS TO THE PLAN FROM 51% OF THE CREDITORS BEFORE OBTAINING THE PROTECTION OF A FEDERAL BANKRUPTCY COURT. UNDER THE REVISED PROCEDURE, FEDERAL PROTECTION WOULD BE PROVIDED UPON THE FILING ONLY OF A SIMPLE PETITION BY THE CITY. AS IS THE CASE WITH RESPECT TO OTHER TYPES OF REORGANIZATIONS UNDER OUR BANKRUPTCY LAWS, THE REORGANIZATION PLAN AND THE CREDITORS' ASSENT THERETO WOULD BE DEVELOPED IN THE COURSE OF THE PROCEEDING. IN THE INTERIM, HOWEVER, THE CITY WOULD BE PROTECTED FROM CONFLICTING CLAIMS AND INJUNCTIONS REGARDING ITS RESOURCES, AND COULD CONTINUE TO CONDUCT ITS AFFAIRS IN AN ORDERLY MANNER.

I WOULD POINT OUT THAT THIS PROPOSAL IS SUBSTANTIALLY CONSISTENT WITH THE RECOMMENDATIONS OF THE NATIONAL COMMISSION ON THE REFORM OF THE BANKRUPTCY LAWS, EMBODIED



FINANCIAL MARKETS

IN ASSESSING THE IMPACT OF A DEFAULT ON THE FINANCIAL MARKETS, WE ARE DEALING IN THE REALM OF JUDGMENTS; AS I HAVE SAID ABSOLUTE CERTAINTY IS SIMPLY NOT POSSIBLE. OUR ANALYSIS IS BASED ON A DETAILED REVIEW OF ALL THE FACTUAL CIRCUMSTANCES, DISCUSSIONS WITH A WIDE RANGE OF MARKET PROFESSIONALS IN THE PRIVATE SECTOR, AND MY OWN CONCLUSIONS, BASED ON MORE THAN TWENTY YEARS OF EXPERIENCE IN THE INVESTMENT BANKING BUSINESS.

THE IMPACT OF A DEFAULT ON MARKETS OTHER THAN THE MUNICIPAL MARKET IS, IN THE FINAL ANALYSIS, CLOSELY RELATED TO THE IMPACT ON THE OVERALL ECONOMY. AS I SHALL DISCUSS MORE FULLY IN A FEW MOMENTS, IT IS OUR JUDGMENT THAT A DEFAULT WOULD NOT DAMAGE THE PROSPECTS FOR THE NATION'S ECONOMIC RECOVERY. THE PUBLIC UNDERSTANDS THAT NEW YORK CITY'S PROBLEMS ARE UNIQUE IN MOST IMPORTANT RESPECTS. MOREOVER, OVER THE PAST SIX MONTHS AND IN THE MONTHS TO COME, THE PUBLIC HAS HAD, AND



WILL HAVE, AMPLE OPPORTUNITY TO DECIDE WHETHER A DEFAULT BY NEW YORK CITY IS MERELY REPRESENTATIVE OF A MORE FUNDAMENTAL FLAW IN OUR ECONOMY. ONLY IF SUCH A CONCLUSION WERE REACHED -- AND THERE IS NO OBJECTIVE REASON WHY IT SHOULD BE -- COULD WE EXPECT A SERIOUS AND LASTING ADVERSE IMPACT ON OUR MARKETS.

MUNICIPAL BOND MARKET

OUR CONCLUSIONS WITH RESPECT TO THE MUNICIPAL BOND MARKET ARE AT ONCE MORE PRECISE AND MORE COMPLEX. OVER AT LEAST THE PAST YEAR, THE MUNICIPAL MARKET HAS BEEN UNSETTLED DUE TO A VARIETY OF COMPLEX FACTORS.

FIRST, THE ENORMOUS VOLUME OF TAX-EXEMPT SECURITIES COMING TO MARKET -- MORE THAN \$51 BILLION OF BOND AND NOTES IN 1974 AND MORE THAN \$40 BILLION IN THE FIRST EIGHT MONTHS OF



THIS YEAR ALONE -- HAS NOT BEEN MATCHED BY A CORRESPONDING INCREASE IN DEMAND FOR SUCH SECURITIES. SECOND, INFLATION AND NOW ITS INEVITABLE HANDMAIDEN -- THE ANTICIPATION OF FUTURE INFLATION -- CAUSED BY MASSIVE FEDERAL DEMANDS ON THE MARKET HAS DAMPENED INVESTOR INTEREST IN COMMITTING FUNDS FOR THE LONG TERM. FINALLY, A SERIES OF EVENTS -- THE REPEAL OF THE PORT AUTHORITY COVENANT BY THE LEGISLATURES OF NEW YORK AND NEW JERSEY; THE DEFAULT BY UDC, OCCASIONED BY THE NEW YORK STATE LEGISLATURE'S INITIAL REFUSAL TO CARRY OUT ITS "MORAL OBLIGATION;" AND THE PROBLEMS OF NEW YORK CITY ITSELF -- HAVE ALL SHARPENED INVESTOR AWARENESS OF RISK AND CREATED AN ELEMENT OF DOUBT ABOUT THE WILLINGNESS OF PUBLIC BODIES TO CARRY OUT THEIR FINANCIAL OBLIGATIONS.

TO A SIGNIFICANT EXTENT, THESE DOUBTS HAVE ALREADY LED TO SOME ADJUSTMENTS IN THE MARKET. IN THE EVENT OF DEFAULT



WE WOULD EXPECT ONLY A TEMPORARY PERIOD OF MODERATE ADJUSTMENT,
AND OVER A SLIGHTLY LONGER TIME FRAME, WE CAN SEE SOME
POTENTIALLY FAVORABLE SIGNS. WE UNDERSTAND THAT NUMEROUS
INTERMEDIARIES AND INVESTORS ARE CURRENTLY WITHHOLDING FUNDS
FROM THE MUNICIPAL MARKET BECAUSE OF THE CURRENT UNCERTAINTIES.
WHEN THE NEW YORK CITY SITUATION IS RESOLVED -- ONE WAY OR
ANOTHER -- WE CAN EXPECT A SUBSTANTIAL RETURN OF FUNDS TO
THE MARKET, IMPROVING LIQUIDITY AND LOWERING BORROWING COSTS.

BUT THE IMPLICATIONS ARE BROADER THAN SHORT RANGE
FUND FLOWS OR PRICE ADJUSTMENTS. SINCE AT LEAST THE BEGINNING
OF THIS DECADE, THERE HAS BEEN A MARKED INCREASE IN THE TENDENCY
OF INVESTORS TO RESTRICT THEMSELVES TO HIGHER-GRADE INSTRUMENTS
A SHIFT IN QUALITY PREFERENCES TO USE THE TECHNICAL TERM.
INFLATION AND ITS BY-PRODUCTS IS THE PRIMARY CAUSE, BUT THERE
IS LITTLE QUESTION THAT MAJOR FINANCIAL REVERSALS -- THE
PENN CENTRAL DEBACLE, FOR EXAMPLE -- HAVE SERVED AS IMPORTANT
CATALYSTS.



CLEARLY, NEW YORK CITY'S SITUATION HAS CAUSED THIS TREND TO ACCELERATE. ISSUERS WHOSE OBLIGATIONS ARE VIEWED AS LESS THAN PRIME ARE PAYING HIGH RATES OF INTEREST RELATIVE TO THE GENERAL STRUCTURE OF INTEREST RATES. CONVERSELY, WELL-RUN ISSUERS ARE BENEFITING IN THE FORM OF LOWER RATES.

IN SHORT, AS WE MOVE FROM A PERIOD OF UNCERTAINTY, UNDERLYING CREDIT CHARACTERISTICS -- FINANCIAL SOUNDNESS -- WILL BE THE DOMINANT FACTOR IN THE PRICING OF ALL MUNICIPAL DEBT. THE RESULT WILL BE A BETTER AND MORE EFFICIENT MUNICIPAL BOND MARKET.

AT THE SAME TIME, WE CANNOT IGNORE THE WAY IN WHICH THE MUNICIPAL MARKET HAS PERFORMED EVEN UNDER THESE SERIOUSLY UNSETTLED CONDITIONS. DURING AUGUST ALONE, FOUR STATES AND 255 MUNICIPALITIES RAISED NEARLY \$2.6 BILLION IN LONG TERM DEBT. AND CONTRARY TO WIDELY HELD OPINION, SUCH FUNDS WERE RAISED AT A COST NOT GROSSLY DISPROPORTIONATE TO HISTORICAL LEVELS.



TRADITIONALLY, THERE HAS BEEN A 30% SPREAD BETWEEN TAX-EXEMPT AND TAXABLE ISSUES OF COMPARABLE QUALITY. WHEN WE HEAR COMPLAINTS ABOUT THE RECORD RATES MUNICIPALITIES ARE PAYING FOR FUNDS, WE MUST KEEP IN MIND THAT CONDITIONS IN THE CORPORATE MARKET ARE NO BETTER. THIS MONTH, THE SPREAD BETWEEN LONG TERM PRIME MUNICIPALS AND COMPARABLE UTILITY ISSUES WAS SQUARELY ON THE 30% FIGURE.

THIS IS NOT TO SUGGEST THAT THE MUNICIPAL MARKET HAS NOT BEEN IMPACTED BY THE UNCERTAINTY SURROUNDING NEW YORK CITY'S CONDITION. BUT IT DOES PLACE THE REACTION OF THE MARKET IN A MORE ACCURATE PERSPECTIVE THAN SOME OF THE RHETORIC OF RECENT MONTHS.

FINALLY, THE DISRUPTIONS WHICH HAVE OCCURRED IN THE MARKET PLACE CAN PROVIDE AN IMPETUS FOR SOME VERY IMPORTANT REFORMS. ONE REASON OUR CAPITAL MARKETS ARE THE FINEST IN THE WORLD IS THAT, UNDER OUR LAWS AND PROCEDURES, INVESTORS ARE PROVIDED WITH DETAILED AND ACCURATE INFORMATION



CONCERNING POTENTIAL INVESTMENTS. TO THE EXTENT INVESTORS BEGIN TO RECEIVE SUCH INFORMATION FROM TAX-EXEMPT ISSUERS, THE MARKET WILL CLEARLY BENEFIT.

NEW YORK STATE AND ITS AGENCIES

WE HAVE TAKEN A PARTICULARLY CAREFUL LOOK AT THE CREDITS WITHIN NEW YORK STATE TO DETERMINE WHETHER ANY CREDIT WOULD BE ABLE TO WITHSTAND AN INCREASED LEVEL OF SCRUTINY. WE NOW BELIEVE THERE IS LITTLE RISK THAT A DEFAULT BY NEW YORK CITY WOULD DIRECTLY PRECIPITATE A DEFAULT BY NEW YORK STATE.

THERE IS A BASIS FOR MORE CONCERN REGARDING SOME OF THE AGENCIES OF THE STATE, PARTICULARLY THE NEW YORK STATE HOUSING FINANCE AGENCY. IN DIFFERENT TIMES, THE ABILITY OF SUCH AGENCIES TO MEET THEIR OBLIGATIONS WAS TAKEN AS A MATTER OF FAITH. BUT THE INCREASED LEVELS OF SCRUTINY HAVE, WE ARE TOLD, PRODUCED INVESTOR MISGIVINGS CONCERNING CERTAIN ASPECTS OF THE PROGRAMS SPONSORED BY THESE AGENCIES. OUR OWN ANALYSIS OF THE PROGRAMS INDICATES THAT THEIR SHORT-



COMINGS CAN BE CORRECTED BY PROMPT ACTION BY THE STATE.
AND THE EXPENSE OF MAKING THE NECESSARY CORRECTIONS, WHILE
MEANINGFUL, IS SMALL IN RELATION TO THE FINANCIAL BURDEN
ON THE STATE IF IT WERE REQUIRED TO AVERT DEFAULT BY
CARRYING OUT ITS MORAL OBLIGATION PLEDGE.

IN OTHER WORDS, IT IS IMPORTANT THAT ACTION BE TAKEN,
AND TAKEN QUICKLY. HOPEFULLY, THE TOO LITTLE, TOO LATE
SYNDROME WHICH FOR MONTHS CHARACTERIZED THE RESPONSE OF
OFFICIALS TO NEW YORK CITY'S PROBLEMS WILL NOT APPLY TO
THE FUNDAMENTALLY DIFFERENT SITUATION CONFRONTING THE
STATE AGENCIES.



LET ME BE CLEAR. - NEW YORK CITY'S DIFFICULTIES DID NOT CAUSE THESE PROBLEMS FOR THE AGENCIES OF NEW YORK STATE. AND A RESOLUTION OF NEW YORK CITY'S PROBLEMS WILL NOT MAKE THEM GO AWAY. FOR THE STATE, AND INDEED ALL ISSUERS OF TAX-EXEMPTS, INCREASED SCRUTINY OF CREDIT IS NOW A FACT OF LIFE IN THE MUNICIPAL MARKET, AND FISCAL SOUNDNESS IS NOW A CONDITION OF ENTRY.

IMPACT ON THE BANKING SYSTEM

AS THE COMMITTEE IS AWARE, THE TREASURY DEPARTMENT, IN CONJUNCTION WITH THE COMPTROLLER OF THE CURRENCY, THE FEDERAL RESERVE BOARD AND THE FDIC, HAS TAKEN A CLOSE LOOK AT THE HOLDINGS OF NEW YORK CITY SECURITIES IN OUR BANKING SYSTEM. WHILE SIGNIFICANT AMOUNTS OF NEW YORK CITY'S DEBT IS HELD BY COMMERCIAL BANKS, WE DO NOT BELIEVE A DEFAULT WOULD HAVE A MATERIAL IMPACT ON THE BANKING SYSTEM.



BUT AS IS THE CASE IN OTHER AREAS, WE HAVE FELT AN OBLIGATION TO DEVELOP MECHANISMS TO MINIMIZE ALL RISKS, HOWEVER, SMALL. ACCORDINGLY, WITH RESPECT TO ANY BANK WHICH MAY BE IMPACTED, VARIOUS MECHANISMS ARE NOW AVAILABLE TO INSURE THAT NONE WILL FAIL AS A RESULT OF A DECLINE IN THE VALUE OF THEIR HOLDINGS OF NEW YORK CITY OBLIGATIONS. BANK CUSTOMERS HAVE NO NEED TO FEAR FOR THEIR FUNDS.

1. WHERE POSSIBLE, BANK DIRECTORS WILL BE REQUIRED TO CONTRIBUTE ADDITIONAL CAPITAL.
2. CERTAIN BANKS MAY BE SOLD TO, OR MERGED WITH, OTHER BANKS OR BANK HOLDING COMPANIES.
3. AS A LAST RESORT, IN APPROPRIATE CASES, THE FDIC MAY PROVIDE CAPITAL IN THE FORM OF CONVERTIBLE



SUBORDINATED DEBT, AT THE SAME TIME IMPOSING
APPROPRIATE SANCTIONS ON THE BANK OFFICIALS DIRECTLY
AND INDIRECTLY RESPONSIBLE FOR THE BANK'S EXPOSURE.

OVERALL ECONOMIC IMPACT

AS I SUGGESTED EARLIER, WE CANNOT CONCLUDE THAT A
DEFAULT BY NEW YORK CITY WOULD RESULT IN A BROAD-BASED DECLINE
IN CONSUMER OR INVESTOR CONFIDENCE OR IN THE ADOPTION OF
UNNECESSARILY RESTRICTIVE LENDING POLICIES BY FINANCIAL
INSTITUTIONS. THE AMERICAN PEOPLE KNOW THE REASONS NEW YORK
CITY IS HAVING FINANCIAL DIFFICULTIES AND THEY KNOW THAT
THERE IS LITTLE, IF ANY, DIRECT RELATIONSHIP BETWEEN THESE
DIFFICULTIES AND THE CONDITION OF THE NATIONAL ECONOMY.

NEW YORK CITY IS FACING A POSSIBLE DEFAULT BECAUSE FOR
YEARS IT HAS SPENT FAR MORE THAN IT TAKES IN. NEW YORK CITY
IS FACING A POSSIBLE DEFAULT BECAUSE, UNTIL RECENTLY,



IT HAS NOT SHOWN ITSELF WILLING TO IMPLEMENT THE NECESSARY REFORM MEASURES REQUIRED TO RESTORE CONFIDENCE AND REGAIN ACCESS TO THE CAPITAL MARKETS. NO CHANGE IN THE NATIONAL ECONOMIC PICTURE WILL MEASURABLY IMPROVE CONDITIONS IN NEW YORK. AND BY THE SAME TOKEN, NO CHANGE IN NEW YORK'S CONDITION WILL MATERIALLY INFLUENCE THE ECONOMY AS A WHOLE.

FEDERAL FINANCIAL ASSISTANCE

THE ONLY EVENT WHICH COULD MODIFY THIS CONCLUSION WOULD BE THE PROVISION OF FEDERAL FINANCIAL ASSISTANCE TO AVERT A DEFAULT. INDEED, SUCH ASSISTANCE -- BE IT IN THE FORM OF A GUARANTEE OR A LOAN, INSURANCE OR A GRANT -- WOULD, IN MY VIEW, ONLY THREATEN THE PROCESS OF RECOVERY.

AS THE CHIEF FINANCIAL OFFICER OF THIS GREAT COUNTRY I HAVE A RESPONSIBILITY TO ALL THE PEOPLE, NOT SIMPLY TO PARTICULAR GROUPS OR SECTORS AT PARTICULAR TIMES. MY JOB, IN ESSENCE, IS TO PROTECT AND RESTORE THE ERODING



FISCAL AND FINANCIAL INTEGRITY OF THE UNITED STATES FOR THE BENEFIT OF EVERY CITIZEN. TO STATE MY VIEWS ON SPECIAL FINANCIAL ASSISTANCE FOR NEW YORK CITY MOST DIRECTLY: I WOULD BE IGNORING THIS FUNDAMENTAL RESPONSIBILITY IF I WERE TO SUPPORT SUCH ASSISTANCE,

FOR YEARS, GOVERNMENT AT ALL LEVELS HAS BEEN PROMISED MORE THAN IT CAN DELIVER. THIS IS THE CAUSE OF NEW YORK CITY'S PROBLEM AND IT IS THE CAUSE OF OUR SEVERE PROBLEMS AT THE FEDERAL LEVEL AS WELL. MORE AND LARGER DEFICITS AND THE INCREASED LEVEL OF FEDERAL BORROWING REQUIRED TO FINANCE THESE DEFICITS HAVE COMBINED TO THREATEN OUR ECONOMIC SYSTEM WITH FUNDAMENTAL CHANGE: NO LONGER CAN WE BE CONFIDENT THAT OUR PRIVATE SECTOR WILL HAVE ACCESS TO THE CAPITAL REQUIRED IF IT IS TO MEET THE NEEDS OF ALL OUR CITIZENS. YET SOME WOULD HAVE US ACCELERATE THESE CHANGES TO DEAL WITH THE CONSEQUENCES OF FISCAL IRRESPONSIBILITY AT THE LOCAL LEVEL.



ANY FORM OF FINANCIAL ASSISTANCE WOULD DIRECTLY INCREASE THE BURDEN THE FEDERAL GOVERNMENT IMPOSES ON THE CAPITAL MARKETS. WHO WOULD SUFFER? ALL BORROWERS, INCLUDING EVERY OTHER STATE AND LOCAL GOVERNMENT, WOULD PAY HIGHER INTEREST RATES. AND CERTAIN SECTORS -- HOUSING, SMALL AND MEDIUM-SIZED COMPANIES, FOR EXAMPLE -- COULD DISCOVER THAT FUNDS WERE NOT AVAILABLE AT ANY PRICE.

MOREOVER, WE DO NOT ESCAPE THESE PROBLEMS BY MAKING THE ASSISTANCE SLIGHTLY LESS DIRECT; BY PROVIDING A GUARANTEE OR INSURANCE FOR MUNICIPAL DEBT. INDEED, SUCH A PROGRAM WOULD CREATE A SECURITY SUPERIOR TO THOSE OF THE FEDERAL GOVERNMENT ITSELF: BACKED BY THE FULL FAITH AND CREDIT OF THE UNITED STATES AND EXEMPT FROM FEDERAL TAXES. THE IMPACT ON ANY MUNICIPAL ISSUER WHICH DID NOT HAVE A GUARANTEE WOULD BE DIRECT AND SEVERE: THE GUARANTEED BONDS WOULD SKIM THE CREAM OF THE MARKET AND ALL OTHER ISSUERS WOULD PAY SUBSTANTIALLY HIGHER RATES.



AND WHAT WOULD SUCH A PROGRAM DO TO FISCAL POLICIES AT THE LOCAL LEVEL? TODAY, THE DESIRE TO MAINTAIN ACCESS TO CREDIT AT THE LOWEST POSSIBLE RATE IS THE MOST IMPORTANT INCENTIVE FOR FISCAL RESTRAINT. A FEDERAL GUARANTEE PROGRAM WOULD PROVIDE ALL PARTICIPANTS WITH THE CREDIT OF THE UNITED STATES: THIS CRITICAL RESTRAINT ON SPENDING WOULD BE LOST ENTIRELY.

BUT, SOME WILL ASK, WHY NOT HAVE THE FEDERAL GOVERNMENT IMPOSE THESE RESTRAINTS AS A CONDITION FOR THE GUARANTEE? THAT POSSIBILITY CONCERNS ME MORE PERHAPS THAN ANYTHING ELSE. WE WOULD HAVE TO CREATE A NEW BUREAUCRACY, SIMPLY TO CONCOCT AND ENFORCE THE GUIDELINES AS TO LOCAL PRIORITIES WE HERE IN WASHINGTON WOULD BE IMPOSING ON THE GOVERNMENTS OF THE NATION. WE WOULD BE CONFRONTED WITH THE SORRY SPECTACLE OF DULY-ELECTED LOCAL OFFICIALS LINING UP OUTSIDE MY DOOR, ATTEMPTING TO PERSUADE ME THAT THEY WERE CARRYING OUT THEIR RESPONSIBILITIES IN A SATISFACTORY FASHION. WE WOULD, IN SHORT, BE CONTRAVENING CONSTITUTIONALLY — IMPOSED PRINCIPLES



OF FEDERALISM; PRINCIPLES WHICH LIE AT THE HEART OF THE
STRUCTURE OF GOVERNMENT IN THIS NATION.

THOUSANDS, PERHAPS TENS OF THOUSANDS, OF GOVERNMENTS
WOULD RESIST THIS INTRUSION INTO LOCAL AFFAIRS. AND
THEY WOULD BE ABSOLUTELY RIGHT. BUT IN THE FINAL ANALYSIS,
THEIR CHOICE WOULD BE A HOBSON'S CHOICE: SUBMIT TO FEDERAL
CONTROL OR PAY THE PRICE OF INDEPENDENCE IN THE BOND MARKETS.
ARE WE REALLY PREPARED TO INFLICT THIS CHOICE ON THE NATION?

FINALLY, THERE ARE THOSE WHO SAY THAT NEW YORK CITY
IS A SPECIAL CASE; THAT HELPING NEW YORK WILL NOT OBLIGATE
US TO HELP OTHER CITIES IN THE FUTURE. BUT WE ARE ALREADY
OBLIGATED. WE ARE OBLIGATED TO LOCAL OFFICIALS THROUGHOUT
THE COUNTRY WHO HAVE RISKED THEIR CAREERS BY INSISTING ON
FISCAL RESTRAINT. WOULD FINANCING THE DEFICITS OF NEW
YORK CITY BE CONSISTENT WITH OUR OBLIGATION TO THEM?

AND CAN WE REALLY DRAW THE LINE AT NEW YORK CITY?

I DOUBT IT. ASSISTANCE TO ONE CITY WOULD CREATE AN INTOLERABLE
PRECEDENT FOR THE FUTURE.



BEFORE CONCLUDING, I MUST RETURN ONCE AGAIN TO AN IMPORTANT POINT. AS STRONG AS OUR ECONOMY AND OUR FINANCIAL SYSTEM MAY BE, IT REMAINS SOMEWHAT VULNERABLE TO ATTACKS FROM WITHIN.

TO THOSE WHO CONTINUE TO INSIST THAT A DEFAULT BY NEW YORK CITY WOULD DEVASTATE THIS GREAT NATION, I SIMPLY ASK: PROVIDE SOME OBJECTIVE BASIS FOR YOUR FEARS AND, IF YOU CANNOT, PLEASE

REMAIN SILENT. WE IN THE ADMINISTRATION HAVE DONE ALL WE CAN TO EVALUATE THE RISKS A DEFAULT PRESENTS AND, WHERE POSSIBLE, TO PROVIDE MECHANISMS TO MINIMIZE THOSE RISKS. BUT IF I MAY BORROW A THOUGHT FROM JUSTICE HOLMES, THE MOST

ELABORATE FIRE PROTECTION SYSTEM IN THE WORLD MAY NOT PROTECT THEATERGOERS FROM THE MAN WHO CRIES "FIRE."

MR. CHAIRMAN, FISCAL RESTRAINT IS NOT AN EASY TASK FOR ANY ECONOMIC UNIT IN OUR SOCIETY -- A PERSON, A

CORPORATION, A PARTNERSHIP, A CITY. I DO NOT WANT TO DEVIATE FROM THE SUBJECT AT HAND, BUT I MUST POINT OUT THAT EVEN WE AS A NATION ARE NOT IMMUNE. ONLY OUR PRINTING PRESS ALLOWS US A



GREATER OPPORTUNITY FOR POSTPONEMENT, WHILE WE DAILY RISK MORTGAGING AWAY THE FINANCIAL HEALTH AND PROSPERITY OF FUTURE GENERATIONS.

BUT OUR ECONOMY -- HOWEVER WEAKENED BY EXCESSES AT THE FEDERAL LEVEL -- REMAINS ABLE TO WITHSTAND EVEN THE MOST SEVERE SHOCKS. I DO NOT WISH A DEFAULT UPON NEW YORK CITY. I DO NOT BELIEVE IT HAS TO DEFAULT AND I EXPECT IT TO TAKE THE MEASURES NECESSARY TO AVOID SUCH AN EVENT. BUT IF IT DOES DEFAULT, THE ECONOMY OF THIS NATION AND ITS FINANCIAL SYSTEM WILL SURVIVE, WITH ENOUGH STRENGTH NOT ONLY TO REPAIR THE DAMAGE, BUT ALSO TO START OUR GREATEST CITY ALONG THE ROAD TO RECOVERY.



PRESENTATION TO PRESIDENT GERALD FORD

ON NEW YORK'S FINANCIAL CRISIS

September 24, 1975

STATUS OF NEW YORK CITY AND STATE FINANCING

Financial Plan

New York City is presently operating under a 90-day \$2.3 billion emergency financing plan enacted by the State Legislature on September 8, 1975. This plan, which extends the State's financial credit to its own credit limits, consists of the following:

1. \$750 million loan from the State to City through purchase of Municipal Assistance Corporation (MAC) bonds.
2. \$250 million bank purchase or underwriting of MAC long-term bonds.
3. \$1,005 billion purchases of MAC notes by various State and City pension and insurance funds and City sinking funds.
4. \$156 million rollover of City securities by commercial banks.
5. \$150 million in prepayment of City real estate taxes.

Emergency Control Board

The legislation also established an Emergency Financial Control Board of seven members (the Mayor, the Governor, the State and City Comptrollers, William Ellinghaus (Pres., N. Y. Telephone); Albert Casey (Pres., American Airlines); and David Margolis (Pres., Colt Industries). The Board is empowered to estimate the revenues of the City and approve a financial plan. In addition, the Mayor must present to the Board a revamped three-year budget plan which would be in balance for fiscal year 1978 under an expenditure ceiling of a 2% growth on controllable items.

New York State has now extended itself to the limits of its fiscal capabilities. According to Standard and Poor's "... While its (the State's) maneuvers up to now appear to be within its financial capabilities, any additional efforts most certainly will strain the State's resources, have a compromising effect on its fiscal integrity and jeopardize its double-A high grade credit rating." It praised the State's "heroic attempts" to stave off default, which "should be well appreciated by all."

Timetable

The State financing plan carries through November 30th. From then on the City must reenter the market on its own. We have a cash now need of \$400 million for December, \$1.36 billion in January, with an additional \$1.82 billion needed in notes issued before the end of this fiscal year.

MAJOR CHANGES IN NYC BUDGET AND MANAGEMENT

At the last White House meeting, it was suggested that New York City should raise the subway fare and institute tuition at the City University. Although neither of those actions are within the power of the Mayor, both have been acted upon. In addition, other major steps have been taken at the direction of the Mayor to institute changes over a short period of months that would normally take years to accomplish.

1. There has been a \$1 billion cut in services in this year's budget, of which \$400 million is due to layoffs.
2. There has been a wage freeze instituted for all employees.
3. There is a firm commitment to a ceiling on expenditures with no increases in taxes.
4. A new Mayor's Management Board has been established to recommend changes in the City's administrative process and to develop greater productivity. The Board is composed of major corporate executives and chaired by Richard Shinn, President of Metropolitan Life Insurance.
5. A Temporary Commission on Long Term Financing has been established by the Mayor, composed of leading experts in urban policy and financing, to develop methods of financing for the City in the future.
6. There is under way a major reorganization of City agencies, including dismantling of the so called "super" administrations, and in some cases the elimination of entire departments.
7. A new accounting system is being implemented to conform to the State controller's Manual.
8. Items appearing in Capital budget appropriations for operating expenses are being shifted back to the regular operating budget.



9. The Metropolitan Transit Authority has raised the fare to \$.50, more than a 43% increase.

10. Although the Board of Higher Education has voted to retain a free tuition policy, the equivalent City tax levy funds for the City University has been cut \$32 million by the Mayor. An additional \$32 million reduction takes place from State funds because the aid program has a matching requirement.

11. In addition, a new Deputy Mayor for Fiscal Affairs has been appointed by the Mayor. Ken Axelson, Vice-President of J. C. Penny has joined the City to develop the fiscal plan to be presented to the Emergency Financial Control Board and to be in charge of all fiscal matters for the Mayor.

FUTURE FINANCING PROBLEM

New York City's expense budget for this year and the following two years must, by the new Statelaw, be limited to a 2% growth, except for uncontrollable items, and be in balance.

In spite of all these measures - and according to many, if not most, bankers, financiers, and economists - no matter what additional cutbacks are instituted, there is a grave question as to whether New York City will be able to reenter the public market in December or January.

Therefore, Federal legislation is needed for the City to be able to market its securities on its own.

Even if the City was compelled to default, and for the sake of discussion it had no adverse affect on the country's economy, New York would still have to finance necessary payments for minimum daily expenses for police, fire protection, education, health and other vital services. Therefore, the Federal government would be faced with the same decision after a default, as it faces today. Since there is at least the possibility that a default by the City and State will have an adverse economic



effect on the nation's recovery program, and since the Federal government will in any case be faced with the same need for financial support for the City, it is logical and practical for such intervention at this time. Waiting until after a default by the City and possibly the State, would compound the overall problem and probably require a larger Federal role than would be necessary at this time. Clearly that was the case with the Penn Central, where bankruptcy not only did not solve their problems but required federal loan guarantees several months later. In addition, the Federal government is still supporting the financing of the rail system.

Presented today are two proposals which would provide the City with the necessary support. Each contains strict limitations concerning application for assistance and would therefore be directed only to those cities, counties, states and businesses which are vital to our economy and cannot obtain credit from the private sector, or from a higher level of government.

OUTLINE OF PROPOSED LOAN GUARANTEE LEGISLATION



New York City needs some kind of guarantee for its notes and bonds in order to reenter the financial markets-whether it be the tax-exempt or taxable market. One possible solution would be a Lockheed-type loan guarantee for which legislation is necessary. Any such bill should include the following points:

1. It would be beneficial for the rest of the tax-exempt market to have such guarantees only for taxable obligations (such as contained in the Housing and Community Development Act of 1974). This would prevent New York from being placed in a position superior to other local governments remaining in the exempt market. It would also close a significant tax shelter, i. e. MAC bonds at 11% tax free. Finally, it would provide relief for a "tight" tax-exempt market by removing for a period of time, its largest borrower.
2. In order to receive guarantees any City would have to meet

several important criteria, including:

- a. Non-availability of credit from the private sector or from the State;
- b. Evidence that revenues are sufficient to cover repayment of principal and interest;
- c. Evidence that budgets will be balanced by real revenues for a number of years;
- d. That only full faith and credit obligations would be eligible for guarantees. This would ensure that the Federal government would have first call on all revenues in the case of a default.

3. There should be the option of providing an interest subsidy for the taxable obligations in order to lessen the burden of debt service costs, a significant part of the City's budget. Previous studies by the Treasury Department show that such a subsidy would actually cost the Federal government less than allowing the security to remain in the tax-exempt market.

4. There should be a clear statement that this in no way endangers the tax exempt status of obligations issued by local governments which are not seeking such guarantees.

OUTLINE OF PROPOSED RECONSTRUCTION FINANCE CORPORATION (RFC)

An alternative proposal to direct loan guarantees for taxable notes would be the creation of a 1975 version of the Reconstruction Finance Corporation (RFC). This mechanism, which assisted businesses and local governments during the Depression Era with more than \$50 billion in loans and loan guarantees has received much support during the past eighteen months.

Such an RFC bill should include the following points:

1. The program should be for all eligible cities and businesses and not limited just to assist New York City.
2. Such assistance should preferably be in the form of direct cash loans, at a favorable rate of interest, to the applicant. The Treasury Department seems opposed to guarantees of obligations because it would make Federal securities more difficult to market, which is particularly important when the Federal deficit is so large. It is felt that a direct cash loan would be less inflationary since the Treasury would be able to decide when to issue financing for the loan and could apread the payments over a period of time more advantageous to the financing of the Federal debt.
3. The RFC might be given power to "tap" the Treasury Department, rather than creating its own "off the budget" fund. This would make all activities of the RFC and individual loans subject to the Congressional appropriations process, thereby showing the Congress and the people just what the effort



is costing. This would contrast greatly to back-door financing whose impact on fiscal matters is difficult to determine.

4. Although the grant of authority to the RFC by the legislation should be broad, it should also be clear in its mandate concerning terms for granting of assistance. Balanced budgets, full faith and credit of the borrower, and other criteria would have to be strictly enforced. If these criteria were strong enough, the number of applicants for assistance would be limited to only those in emergency need of the RFC's help.



THE WHITE HOUSE
WASHINGTON

File
New York
City

INFORMATION

THE WHITE HOUSE
WASHINGTON

September 25, 1975

*Art - discuss Dunham,
1) let's discuss with and
2) The U.P.
Jim*

MEMORANDUM FOR: JIM CANNON
DICK DUNHAM
FROM: ART QUERN
SUBJECT: New York City

This is to suggest a possible course of action in regard to a Federal response to the New York City situation.

I recommend that the President send to Congress a proposal to establish a Special Compact for New York City.

The purpose of this compact would be to let other levels of government share with the Federal government in guaranteeing New York City's bonds.

The proposition would be that the Federal government would provide 60% of the guarantee if:

- a group of states other than New York State would agree to provide 20% of the guarantee (10 states could each agree to 2%).
- a group of cities other than New York would agree to provide 10% of the guarantee (10 cities could each agree to 1%).
- a group of counties outside New York State agree to provide 10% of the guarantee (20 counties at .5% each).

This approach would:

- enable us to engage Congress and other state and local governments in the solution.



- place the burden on Governor Carey and Mayor Beame to move the other parties into the compact.
- deal with this as a unique situation and not establish a new "program" available to all cities.
- determine the willingness of these other parties to back up their statements that the default of New York City would be a terrible problem for them.

I would be pleased to explore this further if you thought it appropriate.

*Also, I wouldn't count
anybody anything if it
worked*

FRD 