The original documents are located in Box 23, folder "New York City Finances (3)" of the James M. Cannon Files at the Gerald R. Ford Presidential Library.

DRAFT

Cannon draft given to Bill Seidman [Oct. 1975]

Last May, after my first meeting with Governor Carey and Mayor Beame about the fiscal problems of New York City, I informed the Governor and the Mayor, and I stated publicly, that the proper place for the resolution of New York City's problem is the State of New York.

Since that time, I have held to this position: There is a solution, but it has to come from the local and responsible state authorities.

Now New York City and State officials, working together on a bipartisan basis, have come up with what is for them a difficult but realistic state program to solve the city's fiscal problems.

I commend them for the way they are meeting their responsibilities. I encourage them to enact their program promptly.

If they do so, I cannot deny a helping hand to the good people of New York who will be making sacrifices in reduced services and increased taxes, or to the city and state officials who will need some temporary financial assistance.

Accordingly, I have asked the Secretary of the Treasury to draft plans - conditional on the State's enactment of the stringent fiscal program set forth by state and city officials -- to provide short-term Federal loans, at interest, to assist New York City in meeting payments for essential city services.

I have also directed the Secretary of the Treasury to continue to monitor all developments related to the New York City's fiscal crisis.

* * * * * *

[Oct. 1975]

Q Federal Govt will work w/Court.

A 1st I don't assume a default. But if it comes - this is a process. Won't prescribe means or methods - Essential services will continue.

Q If default - what would it cost U.S.

A Don't assume a default. Forsee no cost.

Q Difference between Lockheed vs. NYC

A Lockheed may have been a mistake. But defense K'OR dependent to 80 - 85 % of revenues on U.S.G.

Q To assure continued capital flow confidential of investors.

A Best way for the investor confidence to be established is to know and be more discerning about investments in government obligations. Be sure its a good investment.

Q Why not buy Big Mac bonds

A, Legislation would provide priority for new obligations - an orderly process.

Q Your prescription sounds fine for NYC but would it work for U.S. Govt?

A If we don't do some things, as I said we'll face new problems
not an exact analogy but can't just print more dollars, it's not honest.

Presentation of a Gift

Final Question

Q Do you think you'll carry NYC in 1976?

A I'll take my chances. It's a great city - we can solve problem
and do it right - if so I think I'll have a friend or two in NYC.

Q AND A FROM PRESIDENT'S PRESS CONFERENCE - (FROM SPEAKER PHONE) [Oct. 1975]

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[Oct. 1975]

They requested, for example, recommendations from a number of departments through the 40 Committee, which is our intelligence covert activity group that recommends to Presidents actions a President would approve or disapprove.

On the advice of the Attorney General, after thoroughly analyzing the documents requested, the Attorney General has advised me to exercise Executive privilege, which I have.

QUESTION: Do you expect him to be cited by the full Congress and be indeed fined and sent to prison?

THE PRESIDENT: I wouldn't speculate on what the House of Representatives might do, but we have taken this action with reluctance. But, it is important to preserve Executive privilege where recommendations are made by top officials to a President, and I regret very, very much that the committee has taken this action.

I think it is shocking. I think it has very broad and serious ramifications. Over a period of five months, I have tried to cooperate with that committee, giving them tremendous amounts of material, a very substantial number of documents in order to cooperate, but in this case, it doesn't involve my Administration. It involves the period from 1962 to 1972.

I think it is wrong and, therefore, to protect the confidentiality of recommendations from previous Secretaries of State to previous Presidents, I have exercised Executive privilege.

QUESTION: Thank you, and to identify myself, I am Gloria Lane from WSB television.

QUESTION: Craig Lesser, WBHF, Cartersville.

Sir, considering Governor Carey's latest proposals, as well as the serious possibilities of defeat in the New York City primary, to what extent do you support Secretary Simon's latest proposal for aid to New York?

THE PRESIDENT: Let me clear up one thing. I don't think there is a primary in New York. I expect to get very substantial support in New York State when they make the decision at the convention.

The situation in reference to New York is precisely this: Based on the factual situation, I have not changed my decision and have not agreed for any bail-out from New York City. For the first time we have in writing things that the State of New York, the City of New York, the investors and labor organizations have agreed to, but as of this moment, nothing factually has been done.

MORE

One of the matters that they must do, of course, is to re-enact a piece of legislation that permits cities and municipalities to extend maturity dates and to reduce interest rates on certain obligations.

That legislation, I am told, has not yet been enacted. It is, in effect, a procedure under State law that is somewhat comparable to a Federal bankruptcy procedure. But, on the basis of the facts now, there is no change in my position.

We are analyzing the documents received from Governor Carey. We will consult with others. I am encouraged. But, until we have analyzed, until they have acted, there is absolutely no change in my position.

QUESTION: Consider if the legislation is passed, as Governor Carey has suggested yesterday?

THE PRESIDENT: There are a number of other things that have to be done. They have to agree to raise their taxes, city and State. They have to agree to reduce expenditures quite substantially.

Investors have to agree to extend maturities and to reduce interest rates. Labor organizations have to renegotiate the pension plans that have been in effect.

This is a series of steps that must be taken. If and when they are done, of course, we will take another look at it. It is perfectly conceivable, with all of those constructive steps, they might be able to handle their seasonal financing without any Federal intervention.

But, there is a long way to go. We have it on paper, they have promised, but we don't have any action at the present time.

QUESTION: Mr. President, I am Bill Cotterell with United Press International.

Sir, what qualities are you looking for in a Supreme Court Justice? How much have you narrowed down the last, and does it include any Democrats, women, Southerners or members of your Cabinet? (Laughter)

THE PRESIDENT: I am looking for the best person, the best person qualified. We have a preliminary list that the Attorney General has put together. I have asked a number of people to suggest names and a number of people have made such suggestions.

MORE

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editorials

FROM:

Nation's Cities
October 1975
Published by National
League of Cities

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ny-city

Uncle Sam's Emergency Role in New York City

NEW YORK CITY'S LINGERING financial crisis has sent shock waves throughout the nation's municipal bond markets and city halls. At last month's National League of Cities' Effective Government Steering Committee meeting, evidence was presented that even the threat of default on New York City bonds has already driven interest rates up on some recent municipal issues.

Thus the fiscal crisis in the nation's largest city is reaching beyond its boundaries and threatens to engulf municipal capital finance efforts elsewhere. In response, the Effective Government Steering Committee has drafted proposed National Municipal Policy language on "local financial

opposing a continuing system of federal government guarantees or insurance of municipal bonds:

"In addition, municipal governments oppose a continuing system of federal government guarantees of insurance of tax-exempt or taxable municipal bonds."

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The purpose in drafting this latter sentence was to make clear the distinction between actions appropriate in extreme financial emergencies and those appropriate under normal conditions.

These proposed additions to the NLC policy have been sent to the NLC Board of Directors. Through a mail ballot, the board will act ...

Background Paper #1

NEW YORK CITY'S FISCAL PROBLEM: Its Origins, Potential Repercussions, and Some Alternative Policy Responses

October 10, 1975

CONGRESS OF THE UNITED STATES
Congressional Budget Office
Washington, D.C.

PREFACE

New York City's Fiscal Problem is the first in a series of Background Papers issued by the Congressional Budget Office. It was prepared in response to a request from Congressman Thomas L. Ashley of the House Committee on the Budget for background information on the problems confronting New York City and their national ramifications. It is anticipated that Background Papers dealing with topics that are of considerable interest to the Congress and that potentially could affect the economy or the federal budget will be issued at irregular intervals by the Congressional Budget Office. In keeping with CBO's mandate to provide nonpartisan analysis of policy options, the report contains no recommendations. This paper was prepared by Robert D. Reischauer, Peter K. Clark, and Peggy L. Cuciti.

Alice M. Rivlin
Director

October 10, 1975

SUMMARY

New York City's immediate crisis has been precipitated by its inability to borrow in the municipal bond market. Since April when this market closed for the city, a series of stopgap measures have provided the city with the funds it needed to avoid default. The aid provided by the latest of these measures -- the New York State Financial Emergency Act -- will run out in mid-December, if not before, and there are indications that the city and the state may be either unable or unwilling to take the drastic additional steps required to stave off default any longer.

New York must borrow now -- not because it requires funds to finance its long-term capital improvement program, but rather to refund its huge short-term debt. The bulk of this debt is attributable to deficits that the city has run in its expense budget over the past decade. It is estimated that the city's deficit for fiscal year 1976 alone will be over $700 million.

With respect to the size of its short-term debt and its tendency to run current account deficits year in and year out, New York City is clearly unique. However, in other respects, New York resembles many of the other large cities of the northeast and northcentral regions Like them, New York has been subject to pressures for increased spending while its tax base has eroded. However, unlike many of these jurisdictions, New York's revenues and expenditures are unusually sensitive to business cycles and the city has been required by New York State to shoulder an extremely high fraction of its welfare-related expenditures.

Discussion of the impacts of a default by the nation's largest city must be speculative both because there are no precedents for such a default and because much will depend upon the responses of public officials and investors. While severe national economic repercussions are possible if New York defaults, it is also possible that the effects outside of the New York area will be minor. The default procedures established by the New York State Financial Emergency Act call for the ultimate repayment of all principal and interest. In the period before a fiscal reorganization plan could be successfully implemented, some loss would be suffered by those who were forced to sell their New York City securities, but over the long-run the city's obligations are very likely to be met. The short-run impact of a default on banks would probably be moderated by the announced policies of the Federal Reserve System and the FDIC.

So far as other municipalities are concerned, the chief danger is that a default by New York could cause investors to desert the

municipal bond market. If this happened, other jurisdictions that rely on continued access to this market would have to pay higher interest rates and could be forced into temporary default as well. In addition, if New York State, by aiding the city, is forced into the city's predicament, the overall repercussions will be substantially greater.

There are a number of policies that could stave off a default by New York City, but these will require the participation of other levels of government. There is probably little New York City could do on its own that would restore investor confidence to the point that the city could soon reenter the municipal bond market. The state-dominated Emergency Financial Control Board has been given control over New York City's finances and is charged with presenting a three-year financial plan for the city which includes a balanced budget in fiscal 1978. This plan will undoubtedly call for sharp cuts in the city's budget -- cuts that themselves may cause substantial problems for the city and the long-run erosion of the tax base.

Since it seems unlikely that New York City or the Municipal Assistance Corporation will be able to reenter the bond market in December, only additional state or new federal actions will avoid a default. The state could provide the city with grants, borrow in the city's behalf or assume the responsibility for financing some programs such as welfare or higher education that is now borne by the city. The federal government could step in and provide immediate relief for the city through increased grants, direct loans to the city, bond guarantees, or bond reinsurance Combinations of city, state, and federal policies are also possible.

C O N T E N T S

T A B L E S

I. THE BACKGROUND

New York City's current budget problems have been precipitated by its inability to borrow money in the municipal bond market. Since March, when New York was last able to sell notes on its own behalf, a series of stopgap measures have been used to keep the city solvent. First the city was advanced some $800 million in state aid that it was scheduled to receive after the start of the fiscal year in July. Next, on June 10, the state established the Municipal Assistance Corporation (MAC) to serve as an interim borrowing agency for the city, in order to transform much of New York's short-term debt into long-term obligations. Originally, MAC was authorized to borrow $3 billion, an amount sufficient to tide the city over until October. It was hoped that by this time the city would be in a position to reenter the bond market on its own.

While new city securities were unmarketable, it was anticipated that MAC bonds would be viewed differently by investors: first, because they were being issued by an agency of the state and carried with them the "moral obligation" of the state to meet any shortfall in debt services;[1] second, because the revenues from the city's sales and stock transfer taxes were to be diverted directly to the corporation to cover its debt service costs; and finally, because the city was directed to reform its financial practices and balance its budget under a new, state-approved accounting system.

In spite of these assurances, MAC immediately encountered difficulty borrowing for the city. Although MAC's first issue bore unprecedented tax-exempt interest rates of up to 9.5 percent, it could be marketed only with difficulty, even after a number of banks and insurance companies agreed to buy two-thirds of the total. When these bonds were freed from the sales price restrictions placed on them by the underwriting syndicate, they immediately plummeted in value, confirming a lack of investor interest in MAC bonds. In August MAC was able to borrow less than half of its planned offering, even though the

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1. A "moral obligation" requires the governor to include in his proposed state budget funds sufficient to cover any shortfall in debt service. This does not legally bind the legislature to appropriate these funds as would be the case of shortfalls associated with securities backed by the state's "full faith and credit."

59-833 O - 75 - 2

new issue carried interest rates of up to 11 percent.

As August wore on, the New York clearing house banks that usually market New York City offerings became more reluctant to underwrite new MAC issues because these institutions were experiencing increasing difficulties reselling the bonds they already held to other investors. They found themselves holding more city obligations than they considered to be prudent banking practice. Thus in September MAC found itself in the situation that had faced the city in April -- unable to find a syndicate that would underwrite its borrowing.

The next stopgap measure was the Financial Emergency Act, which was approved by a special session of the state legislature and signed by the governor on September 9. This legislation was part of a plan to provide the city with roughly $2.3 billion -- enough to meet its cash requirements through early December, by which time it is hoped the other elements of the plan will allow the city to reenter the bond market on its own. The key element in the plan is the Emergency Financial Control Board which is dominated by state appointees and charged with administering the city's finances. By late October this board must approve a three-year financial plan that includes transition to a truly balanced budget by fiscal year 1978, a reduction in short-term city borrowing, the removal of expense items from the capital budget, and a growth in controllable spending (all but welfare, pensions and debt service) of not more than 2 percent per year. The board is also given the responsibility for estimating the city's revenues and keeping spending within these revenue limits; reviewing and approving major contracts; approving all city borrowing; extending, if necessary, the pay freeze on city employees through fiscal year 1977; and dispersing city revenues, but only after it is satisfied that the expenditures are consistent with the three-year fiscal plan. The powers of the board extend to the city's semi-independent agencies which provide elementary and secondary education, higher education, hospital, and other services.

As with MAC, the emergency assistance plan ran into difficulties soon after it was put into effect, giving rise to concerns that this stopgap measure might not be sufficient to keep the city solvent even until December. Banks, insurance corporations, and private investors have not agreed to buy the full $406 million in MAC bonds that the plan calls upon them to purchase. Some of the city and state pension funds, which are legislated to supply $755 million of the $2.3 billion total, have balked at investing in MAC bonds. The state pension funds have obtained a New York State Court of Appeals ruling, which states that, despite the provisions of the Financial Emergency Act, they cannot be required by legislation to purchase MAC bonds. Finally, the state, which has agreed to loan the city $750 million, has encountered increasing difficulty in borrowing.

Although these notes were backed by the "full faith and credit" of the state, the state was forced to pay 8.7 percent on the first notes

issued to aid the city. Next, Standard and Poor's, which rates the risk associated with various municipal bonds, warned that, if the state extended more assistance to New York City than that called for in the emergency plan, it would be compromising its fiscal integrity and jeopardizing its high credit rating. Finally, Moody's Investors Service, another organization that rates bonds, withdrew its rating from the state's Housing Finance Agency, effectively squeezing this agency out of the municipal bond market and leaving it dependent upon the state for capital.

Moody's also lowered its rating of New York state and city securities. Thus it seems possible that, if it increases its support for the city, the state of New York may find itself in the same situation that faced the city in April and faced MAC in September. Yet, without further state involvement, it is unlikely that either MAC or the city will be able to market bonds after November. If this is the case, then for the third time this year New York City will be denied direct or indirect access to the municipal bond market. But why does the city need to borrow? And what would occur if continued access to the bond market were denied?

II. THE CITY'S NEED TO BORROW

While most state and local governments borrow money, many can postpone issuing bonds or notes for a few months or even for an entire year if conditions in the municipal bond market appear to be adverse. However, New York City's situation makes such a delay impossible. In fiscal year 1976, the city's anticipated borrowing requirements are approximately $8 billion. This borrowing has three different purposes.

Capital Projects. First, like almost all state and local governments, New York City borrows to finance capital projects. Generally long-term bonds are issued to pay for the construction of schools, public buildings, highways, sewers, and similar projects. The accepted rationale for financing such facilities with long-term debt is that all of the taxpayers who will benefit from such long-lived facilities should pay for them, and such payments should be made in installments during the facility's usable life span. As of June 1, 1975, New York City had $9.4 billion outstanding in long-term debt, the great bulk of which was backed by the city's "full faith and credit" through a first lien on tax revenues. A small portion of the debt was offset by money deposited in sinking funds. This debt represents roughly 6 percent of the nation's total long-term municipal debt.

Short-term bond anticipation notes are used by some states and local governments to support the construction phase of a project or to avoid borrowing in the long-term market when interest rates are abnormally high. New York has depended heavily upon issuing such notes, $1.6 billion of which it had outstanding on June 30, 1975. Frequently the city has made little or no effort to substitute long-term borrowing for such bond anticipation notes, preferring instead to "roll over" or refund these obligations periodically. This has made New York particularly dependent upon continued access to short-term credit markets.

While long- and short-term borrowing for capital projects is accepted practice, there is evidence that in recent years New York has misused such borrowing authority by placing approximately $700 million worth of items, which appropriately belonged in its operating budget, into the capital budget. This was one of the "gimmicks" the city used to present a "balanced" operating budget.

According to the city's budget, it planned to issue roughly $2 billion in new obligations to support capital projects and to "roll over" between $1.2 and $1.8 billion in bond anticipation notes in

fiscal year 1976. If the city were unable to borrow for these purposes, its large capitalimprovement and construction program would eventually grind to a halt, causing a general deterioration of the city's stock of public buildings and facilities and exacerbating unemployment in the construction industry. Possibly of more immediate significance would be the necessary termination of the operating budget items that have been hidden in the capital budget.

Expenditure and Revenue Flows. The second purpose for which New York borrows is to match its income flow to its expenditure pattern. Spending occurs at a fairly regular pace throughout the year, driven by payrolls and welfare payments that must be met bimonthly or monthly and by the steady purchase of the goods and services required to keep city programs operating. Revenues, on the other hand, come in at more infrequent intervals. For example, property taxes are collected quarterly, state and federal aid may be paid quarterly or even annually. Lacking large unencumbered cash balances, New York, like some other states and municipalities, issues tax and revenue anticipation notes to tide itself over until the taxes or other revenues are obtained. If it operated in a prudent fashion, New York could be expected to require approximately $1.5 billion in short-term debt in fiscal year 1976 for "legitimate" revenue anticipation purposes ("legitimate" in the sense that these notes could be repaid by revenues collected during the fiscal year). Without access to such borrowing, the city would have to reshape its expenditure pattern to that of its receipts or to build up cash balances sufficient to tide itself over periods of low revenue inflow.

Short-term Notes for Deficit Financing. The final purpose for which New York City needs to borrow in fiscal year 1976 is to "roll over" or refund $2.6 billion in outstanding short-term notes and to finance this year's $726 million projected current account deficit. The $2.6 billion represents the accumulation of the past decade's operating deficits which have been financed each year primarily by issuing more revenue and tax anticipation notes than could be covered through actual revenue collections. The existence of this large short-term debt and the magnitude of the current deficit mean that New York must borrow every month or so regardless of how unattractive market conditions may be to "roll over" the part of its short-term debt coming due and to finance its monthly shortfall between current revenues and expenditures. The only alternative would be to repay the principal and interest due out of current revenues. The impracticality of this approach can readily be seen by the fact that it would absorb roughly half of the city's annual tax revenues, leaving little to support essential public services.

New York City had $5.3 billion of short-term notes -- 29 percent of the national total -- outstanding on June 1, 1975. Had the market not closed for the city, New York could have been expected to issue between 27 and 33 percent of 1975's total short-term municipal notes.

To summarize, New York's borrowing needs in fiscal year 1976 total some $8 billion. Had a crisis of confidence not emerged, the city would have issued $2.6 billion long-term securities and sought an additional $6 billion in the short-term market. Instead, the market effectively closed to New York City in April. MAC, first on its own and then with the assistance of the state, has stepped in to borrow for the city. The strategy behind this intervention is to substitute long-term securities for short-term notes, thus providing the city with an opportunity to reform its fiscal practices and accumulate surpluses sufficient to repay its past deficit-related debts.

III. CAUSES OF THE PROBLEM

A variety of factors have contributed to New York's current fiscal problems. It is useful to distinguish the short-term factors that are responsible for precipitating the immediate crisis from those longer-term trends that have contributed to the city's deteriorating fiscal position.

Short-term Factors. The immediate crisis stems from a loss of investor confidence in the credit worthiness of the city. To some extent the sudden shift in the attitudes of investors towards the city's ability to meet its obligations must be attributed to psychological factors for surely the city's long-run economic outlook, which is what determines its ability to pay off its debts, cannot be much different today than it was one or two years ago.

Any discussion of the factors that affect the psychological attitudes of investors must be speculative. It is possible that investor confidence was eroded by the public debate and confrontation politics that took place between the mayor, the city controller, and the governor over the city's fiscal year 1976 budget. It is also probable that the temporary default of the New York State's Urban Development Corporation and the memories of the Penn Central, Lockheed, and Franklin National Bank collapses have made investors increasingly skittish. Any hint of financial instability may send them scampering away. Investor uncertainty becomes a self-feeding process, for the fewer the number of persons willing to lend the city money, the greater the probability of default and the greater therefore the uncertainty, and indeed, the risk.

However, it would be wrong to attribute all of the loss of investor confidence in New York to psychological factors. Objective market conditions should be considered as well. As Table 1 indicates, 1975 has proven to be an extremely heavy year for municipal borrowing. Therefore, New York has been forced to compete for funds with many other state and local governments with far sounder fiscal conditions as well as with the large borrowing requirements of the federal government. While the volume of issues has grown, the recession probably has diminished the desire and ability of banks, corporations, and individuals to buy tax-exempt bonds. This has clearly been the case with commercial banks; during the first quarter of 1975 they dropped out of the municipal bond market almost entirely (see Table 2).

With respect to individuals, it has been suggested that interest rates on municipal offerings have to be raised significantly to entice new buyers into the market. Such buyers must be drawn primarily from middle- and lower-income groups which benefit less from the tax-exempt status of municipal bond interest and are less capable of purchasing municipal bonds because these securities generally are available only in large denominations.

TABLE 1 -- Volume of Municipal Borrowing (1967-1975)
(Amounts are par values in millions of dollars)

Year	Long-term	Short-term	Total
1967	14,300	8,000	22,300
1968	16,300	8,600	24,900
1969	11,700	11,700	23,400
1970	18,888	17,811	35,999
1971	25,006	26,259	51,265
1972	23,748	24,705	49,018
1973	23,957	24,705	48,662
1974	24,317	29,543	53,860
1975*	30,124	33,932	64,056

Source: Securities Industry Association, Municipal Market Developments.

*Annual rate based on January - June volume.

TABLE 2 -- Annual Net Changes in Holdings of Municipal Securities by Major Holder Groups (1970-1975)

(Amounts are par values in billions of dollars)

Holder	1970	1971	1972	1973	1974	1975* First quarter	1975* Second quarter
Commercial banks	10.7	12.6	7.2	5.7	5.5	-2.7	6.9
Households	-.8	-.2	1.0	4.3	10.0	13.9	9.3
All other**	1.3	5.2	6.2	3.7	1.9	2.9	4.5
Total	11.2	17.6	14.4	13.7	17.4	14.0	20.7

Source: Unpublished flow of funds data from the Board of Governors of the Federal Reserve System (Processed: August 19, 1975)

* Annual rate.

** This includes corporate business, state and local general funds, mutual savings banks, life insurance companies, state and local government retirement funds, and brokers and dealers.

Furthermore, the market for New York City securities is concentrated largely in New York State where the interest is exempt from not only federal but also state and local taxes. This market may be close to saturated by the large quantities of state and city securities outstanding. To broaden the market to nonstate residents would require interest rates sufficiently high to compensate for the fact that non-New York holders would have to pay state income taxes on the interest earned from their New York City securities.

The recession is a second short-term condition that has contributed to New York City's problems. Compared to other local governments, New York's revenue system is highly responsive to economic conditions because it relies heavily on cyclically sensitive sales and income taxes rather than on the more stable property tax. While property taxes accounted for 62 percent of the total revenues raised by the local governments serving metropolitan areas in fiscal year 1972-73, they accounted for only 43 percent of revenues raised by New York.

The recession's impact on New York's sales tax base is illustrated in Table 3. Despite a 9.3 percent increase in consumer prices in the year ending June 30, 1975, the volume of taxable sales in the city rose by only 1.7 percent. In New York even the property tax has proven to be unreliable. Delinquencies have risen rapidly from 4.2 percent of collections in fiscal year 1970 to 7.2 percent currently.

The recession has caused high unemployment and stationary incomes which have increased the city's expenditure requirements as well as undercut its expected revenue growth. Not only have the numbers of families eligible for welfare programs increased (see table 3), but it is also likely that the demand for other city services, such as hospitals, has been boosted by the recession because fewer city residents are able to afford the costs of the alternative private institutions.

The severe inflation of recent years has also had a negative effect on the fiscal position of New York. While in the long run, inflation may increase the value of the local tax base sufficiently to compensate for the decreased purchasing power of the tax dollar, in the short run, expenditure levels tend to be more responsive to inflationary pressures. This imbalance stems from the nature of property tax administration, for it is very difficult to reassess property rapidly enough to keep pace with the continually inflating market values of real estate.

Moreover, the situation is exacerbated by the long time period that transpires between the date at which the property tax levy is set and the dates on which the tax payments are due. In recent years a considerable amount of unanticipated inflation has occurred during these periods. It should be noted that New York's situation with respect to inflation may be better than that of other large cities, because of New York's heavy reliance on sales and income tax receipts which do respond quickly and automatically to price hikes and inflation-induced salary increases.

59-833 O - 75 - 3

TABLE 3 -- Indexes of the Recession's Impact on New York City*

Year	Unemployment Rate[1]	Welfare Recipients[2]	Sales Tax Base[3]
1970	4.8	101.5	78.1
1971	6.7	109.5	81.5
1972	7.0	112.9	NA
1973	6.0	106.4	91.9
1974	7.2	101.4	96.7
1974 June	6.9	100.0	100.0
July	7.3	100.2	100.4
Aug.	6.8	99.3	100.2
Sept.	7.3	100.5	99.1
Oct.	7.2	101.3	99.8
Nov.	7.4	101.3	99.6
Dec.	8.5	102.4	100.4
1975 Jan.	10.3	102.8	101.0
Feb.	10.2	102.5	101.0
Mar.	11.0	103.1	101.7
April	10.8	104.3	102.0
May	10.9	104.3	101.9
June	11.7	105.0	101.7
July	12.0		
Aug.	11.0		

Sources: 1. New York State, Department of Labor
2. New York State Department of Social Services
3. Annual figures from New York State Department of Taxation and Finance. Monthly figures from Municipal Assistance Corporation

*Indexes use June 1974 as the base period (Sales Tax Base 100 = $1.6 billion; Welfare Recipients 100 = 949,000). Sales Tax Base is equal to the total value of sales subject to taxation. Index is based on a twelve-month moving average to eliminate seasonal effects.

The Welfare index includes recipients under the AFDC and home relief programs.

Long-term Factors. The longer-term roots of New York's fiscal problem are both complex and difficult for the city to change. In part they represent the same forces that have buffeted the other large central cities of the northeast and north-central states. These cities have been called upon to assimilate a new wave of rural migrants into the industrial economy just when the industries offering employment opportunities are shifting their bases of operation out of the cities.

As a result of the immigration from the South, the out-migration to the suburbs, and the natural aging of the existing population, those more heavily dependent on city services -- the poor, the uneducated, the aged, the non-English speaking -- comprise an ever-increasing segment of the city's population. For example, between 1950 and 1970 the fraction of the city's population over 65 years of age has gone from 8.0 to 12.1 percent while the proportion of the city's families with incomes below the nation's median income level has risen from 36 to 49 percent.

The city's tax base has failed to grow as rapidly as its revenue requirements. This situation can be attributed to shifts in the location of economic activity as well as to the continued suburbanization of middle- and upper-income groups. Many industries are leaving the northeast altogether while others find it more profitable to operate in the suburbs or on the fringes of the metropolitan area. While its population has remained relatively constant, New York has lost jobs at a rapid rate over the last fifteen years (see Table 4).

TABLE 4 -- Change in Jobs and Population in New York City

Year	Total Jobs[1] (in Thous.)	Index*	Private Sector[2] Jobs (in Thous.)	Index*	Population[3] (in Thous.)	Index*
1960	3,538.4	94.5	3,130.2	98.4	7,782.0	98.6
1970	3,744.8	100.0	3,182.0	100.0	7,895.6	100.0
1971	3,609.4	96.4	3,040.2	95.5	7,886.6	99.9
1972	3,563.1	95.1	2,998.6	94.2	7,847.1	99.4
1973	3,538.4	94.5	2,964.0	93.1	7,664.4	97.1
1974	3,458.4	92.4	2,877.7	90.4	7,567.1	95.8
1975**	3,375.8	90.1	2,802.6	88.1	NA	NA

Sources: 1,2 -- Bureau of Labor Statistics
3 -- Bureau of the Census

* Data Indexed using 1970 as base year.
** January - June 1975

The city can exert little influence over either the population shifts or the tax base trends. Together they have produced a steady increase in city tax levels which has, in turn, probably affected the types of persons and businesses willing to remain in or move into the city (see Table 5).

TABLE 5 -- The New York City Tax Burden

Fiscal Year	Personal Income ($ billions)	Taxes* ($ billions)	Taxes as Percent of Personal Income
1963-64	50	5.111	10.2
1964-65	48	4.506	9.4
1965-66	45	4.017	8.9
1966-67	43	3.736	8.7
1967-68	41	3.178	7.7
1968-69	39	2.958	7.5
1969-70	37	2.802	7.6
1970-71	34	2.626	7.8
1971-72	31	2.410	7.7
1972-73	29	2.152	7.3
1973-74	28	2.193	7.9
1974-75	27	2.013	7.6

Source: New York City Finance Administration.

*Excludes fees and charges, stock transfer taxes and nonresident income taxes.

An additional factor that has contributed materially to the city's fiscal problems is the manner in which the responsibility for providing welfare and health care services has been divided in New York state. New York is one of only twenty-one states that requires its local governments (e.g. counties) to contribute to the support of cash assistance for the aid to families with dependent children program (AFDC) or to Medicaid payments. Of these twenty-one states, the local share is the highest in New York, where it amounts to almost one quarter of the total or half of the nonfederal share (see Table 6).

TABLE 6 -- Fraction of AFDC Cash Assistance and Medicaid Payments Borne by Local Governments (Fiscal Year 1974)

State*	Percent
New York	23.0
Minnesota	21.8
Wyoming	18.5
California	14.5
Kansas	11.3
Colorado	9.4
Nebraska	8.8
Nevada	8.3
No. Carolina	8.3
Indiana	6.9
New Jersey	6.5
Iowa	4.8
No. Dakota	4.6
Maryland	4.2
Montana	2.8
Virginia	0.6
Utah	0.6
Louisiana	0.2
Oregon	0.1
New Hampshire	**
Mississippi	**

Source: Department of Health, Education, and Welfare, "State Expenditures for Public Assistance Programs."

* States not listed do not require any local contribution.
** Less than 0.1 percent.

While county governments in New York also must bear half of the cost of the Home Relief Program, New York State's relatively generous general assistance program, this division of responsibility does not differ from the pattern that prevails in the rest of the nation. All told, New York City's welfare-related expenditures amount to some $4 billion, or approximately one third of its current spending. One billion dollars of this must be raised by the city. If the city constituted just part of a large county -- as is true of Los Angeles, Newark and all but a handful of the large cities located in the twenty-one states requiring local welfare contributions -- the costs of supporting the city's income security programs would be shared by some suburban jurisdictions. However, being a city-county, New York must bear the cost alone.

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

Finally, one cannot ignore the city's questionable accounting procedures and loose fiscal management in relation to the current crisis. These procedures masked the fact the New York officials were failing to make the difficult choices that were required if the city's expense budget was to be truly balanced as required by law.[1] The fault does not rest with the city alone. Many of the "gimmicks" which allowed the budget to appear balanced were tolerated or even suggested by state officials and were certainly not secrets to the banking community. These "gimmicks" produced small deficits which were allowed to accumulate and grow, producing a problem of large and unmanageable proportions.

[1] "Annual budget and financial reports are filed with the Division of Municipal Affairs in the office of the State Comptroller. Budgets are reviewed in substance and legality.... Deficit financing is not recognized in the operation of units of Local Government in New York State and can only be legally validated by legislative enactment." Advisory Commission on Intergovernmental Relations, City Financial Emergency, Washington, D. C. 1973, p. 168.

IV. IS NEW YORK UNIQUE?

Are New York's problems simply of a larger magnitude or are they qualitatively different from those of other major cities? Much of the public discussion suggests that New York is very different from other cities, that it has an abnormally large welfare population, an unusally large and well-paid public labor force and has expenditure patterns that are significantly higher than other cities. At the same time, there is the belief that the fiscal crisis being visited upon New York soon will afflict other cities. Generally neither of those contradictary sets of impressions is valid.

In recent decades New York has been buffeted by the same socio-economic forces that have affected other large, older urban centers and has responded to these pressures in a fashion similar to that of other cities. According to most measures, New York's situation is far from the worst in the nation. One composite index of central city disadvantage shows New York in better shape than Newark, Baltimore, and Chicago as well as eight other large urban centers not included in Table 7 (see column 1). A smaller fraction of New York's population receives welfare than is the case in Philadelphia, Baltimore, Newark, or Boston (see Table 7, column 2).

Comparisons of the expenditure and employment patterns of New York City with those of other large municipal governments indicate that New York is far out of line with other jurisdictions (see Table 7, columns 3a and 4a). Yet this is a misleading conclusion which stems from the fact that New York City provides services that in other areas may be supplied by a county government, a school district, or another specialized government. If one compares the New York employment and spending patterns with those of all of the local governments providing services to the residents of other large cities, New York appears to be less extraordinary (see Table 7, columns 3b and 4b). While its per capita expenditure and public employment levels are above those of any other major city area, some of the differences with respect to such cities as Boston and Philadelphia can be explained by the fact that welfare is a state function in Massachusetts and Pennsylvania. While New York also spends a great deal more than other cities on higher education, hospitals, and mass transportation, its expenditure on the services commonly provided by municipalities is not out of line with those of other large cities (see Table 7, columns 3c and 4c). With respect to the salaries paid public employees, New York is generous but not the most generous of large cities (see Table 7, column 5). Considering that New York's cost of living -- as measured by the Bureau of Labor Statistics (BLS) intermediate family budget -- is

TABLE 7--New York City Compared
To Other Large Central Cities

City	(1) Index of Central City Dis-advantage	(2) Fraction of Popu-lation Receiving Welfare Payments*	(3) Per Capita Expenditures 1972-1973			(4) Local Government Employment Per 10,000 Population 1974		
			(a) Central City Govern-ment	(b) All Local Governments Serving Central County*	(c)	(a) Central City Govern-ment	(b) All Local Governments Serving Central County*	(c)
				Total	Common Muni-cipal Func-tions**		Total	Common Municipal Functions**
New York City	211	12.4	$1,224	$1,286	$435	517.1	528.2	242.9
Boston	198	16.9	858	756	441	378.0	465.0	219.2
Chicago	245	11.1	267	600	383	140.0	352.5	208.4
Newark	422	14.4	692	827	449	391.1	421.5	258.2
Los Angeles	105	8.0	242	759	408	162.2	401.1	206.2
Philadelphia	205	16.2	415	653	395	163.8	414.5	255.2
San Francisco	105	9.1	751	1,073	488	312.5	488.3	224.6
New Orleans	168	11.4	241	431	260	177.3	357.7	217.5
St. Louis	231	15.8	310	610	360	241.9	424.6	214.2
Denver	143	7.2	473	721	375	237.0	410.5	219.3
Baltimore	256	16.3	806	814	470	434.1	434.1	260.1
Detroit	210	11.1	357	650	396	194.8	354.3	202.4

* Central County.
** Common Municipal Functions include elementary and secondary education, highways, police, fire, sanitation, parks, general control and financial administration.

continued

TABLE 7 -- (Continued) New York City Compared
To Other Large Central Cities

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

Sources:

1. Richard Nathan "The Record of the New Federalism: What It Means for the Nation's Cities." Brookings Institution, 1974.
2. Department of Health, Education and Welfare, Recipients of Public Assistance Money Payments and Amounts of Such Payments by Program, State, and County. February 1975 DHEW Pub. No. (SRS) 76-03105 NCSS Report A-8 (2/75). Includes AFDC and general assistance recipients.

3a. U.S. Bureau of the Census, "City Government Finances in 1972-73," GF73, No. 4.

3b,c,7 U.S. Bureau of the Census, "Local Government Finances in selected Metropolitan Areas and Large Counties 1972-73," GF 73, No. 6.

4. & 5. U.S. Bureau of the Census, "Local Government Employment in Selected Metropolitan Areas and Large Counties 1974," GE74, No. 3.

6. Bureau of Labor Statistics, "Autumn 1974 Urban Family Budgets and Comparative Indexes for Selected Urban Areas." (4-9-75).

* Central County

higher than all but that of Boston, its wages are not particularly out of line (see Table 7, column 6).

However, it should be noted that what little reliable evidence there is seems to indicate that New York City provides its employees with considerably more in the way of fringe benefits--pensions, health insurance, etc.--than is offered the employees of other large cities.

While New York's situation in many ways does not differ markedly from that of other large central cities, some of its problems are clearly not shared with other cities. First there is New York's debt situation. On a per capita basis the city has far more debt outstanding than do the local governments providing services in the other central city areas (see Table 7, column 7). This is particularly true of short-term debt in which New York stands alone in its needs continually to enter the market to "roll over" large quantities of notes. Second, New York, as far as can be told, has been the only major city that has chronically run a large current operating deficit in both good and bad economic years. Finally, as was mentioned previously, New York revenues and expenditures are much more sensitive to the ups and downs of the business cycle. All of these peculiar aspects of New York's situation should make one pause before concluding that the city's crisis is but the forerunner of those that will occur widely elsewhere.

V. THE EFFECTS OF DEFAULT

New York City is likely to default on its obligations if, as now seems probable, the city and the state or MAC acting in the city's behalf are unable to borrow large amounts of funds after the transfusion provided by the emergency assistance plan is used up. Just what form a default would take and what the repercussions of such an event would be cannot be predicted with any degree of certainty. While it is possible that the collapse of New York would precipitate a storm of bankruptcies in the private sector and a wave of municipal defaults, it is also possible that a default by the city would generate but a ripple on the nation's financial waters. Much would depend upon how public officials and policy makers chose to deal with the situation and how default would affect the psychological attitudes of investors.

The New York State Financial Emergency Act authorizes a procedure that would probably be followed in the event that the city were forced to default on its obligations. Under this procedure, no creditor would be permitted to seek ameliorative action in the courts for thirty days. During that time, the municipality or the Emergency Financial Control Board could file a voluntary petition to the state supreme court indicating its inability to pay its debts and stating its intention to file a repayment plan. On receipt of the petition, the court would stay invidividual court proceedings for an additional ninety days. The repayment plan would have to provide for the eventual payment of both principal and interest. This payment would have to be made as soon as possible, although consideration would be provided for the maintenance of essential public services. Any creditor who agreed to receive payments under the plan would be enjoined from further court actions.

It is important to recognize that the procedure outlined in the Financial Emergency Act is for <u>default</u> rather than <u>bankruptcy</u>; under the default procedure all debts must be paid eventually. The state law also permits the city, if it prefers, to file for bankruptcy under the Federal Bankruptcy Act. Under that law, 51 percent of all creditors must petition the court to initiate proceedings; creditors holding two-thirds of all outstanding debt must agree to a financial adjustment plan which spells out the timetable and extent to which creditors would be repaid. Since New York City issues "bearer" rather than "registered" obligations, no one has an exact fix on who the city's creditors are. Lacking this information, it may be impossibly complex for the city to use the procedures of the Federal Bankruptcy Act.[1]

[1] Treasury Secretary William Simon, testifying before the Joint Economic Committee of Congress on September 24, 1975, indicated that the Administration soon would propose amendments to the Federal Bankruptcy Act that would make this Act more useful to local governments. A number of bills having this objective have been introduced by members of the Congress and hearings are scheduled or have taken place in both houses.

Even a default under the Financial Emergency Act would, no doubt, involve some losses to holders of New York City debt. The bonds and notes would be relatively illiquid until the reorganization plan was approved and the city showed that it could meet the repayment schedule. Debtholders forced to sell their bonds or notes during this period of illiquidity could suffer substantial losses. Debtholders who were able to maintain their position until the repayment plan proved workable might not sustain any loss if market rates of interest were paid for the extended payment period. In fact, holders of city securities that were purchased during the period of uncertainty when yields were high might reap large capital gains, if the city showed an ability to meet the repayment schedule and if this pushed the interest rates the city had to pay for new borrowing below the levels of the past six months.

The extent to which the value of bonds in default would be depressed would be related to the market's assessment of the repayment plan and New York's ability to meet it. Certainly the bonds would not become worthless, but the losses could significantly affect the behavior of their holders. While no one can provide a precise figure, banks hold a substantial amount of New York's securities. It has been estimated that the large New York City banks hold roughly $2 billion of the $14.6 billion in outstanding debt. Two billion dollars represents less than 25 percent of the equity capital of these banks and something under 5 percent of their total assets. Other banks throughout the nation also hold New York securities. A recent survey by the Federal Deposit Insurance Corporation (FDIC) of the roughly 9,000 banks that are not members of the Federal Reserve System indicated that approximately sixty had more than half of their capital in New York City securities; another 200 had between 20 and 50 percent of their capital invested in such bonds and notes. Probably a similar proportion of the approximately 5,000 banks that are members of the Federal Reserve System have large holdings of New York City securities.

Banks holding large amounts of city securities would not be unscathed if New York's bonds and notes plummeted in value because of a default. However, the impact would be lessened by the Federal Reserve's stated willingness to both lend funds to member and nonmember banks whose solvency would be jeopardized by a city default and to permit banks to value city securities at their predefault levels. The FDIC's contingency plan to lend funds to banks caught by a municipal default rather than forcing these institutions into receivership would have a similar effect. Under such conditions it is doubtful that any banks would be forced into bankruptcy if the restructuring of the city's fiscal situation is accomplished in a reasonable period of time. In any case it should be noted that the FDIC would protect all but the largest depositors from suffering any loss should there be any bank failures.

Insurance companies and individuals also hold a large portion of New York City's debt. It is unlikely that the former would be seriously affected because their payout streams are generally very uniform and they usually have highly diversified sources of income. Individuals would be hurt to the extent that the market value of the defaulted bonds fell, but the vast majority of such holders are high-income persons who have been attracted to municipal bonds by the tax-exempt status of the interest. Most such persons presumably have other resources to fall back on if their interest earnings and assets from New York City shrink.

The impact of a New York City default on the municipal bond market is much more hazardous to predict. To date, the evidence indicates that New York's problems have had little, if any, impact on the situation facing most municipal borrowers. Yields on municipal issues have maintained their historic relationships to those on corporate issues of comparable maturity and quality (see Table 8). While municipal rates have edged up recently, so too have the rates for corporate and federal securities. Of course, it is possible that when more recent data are processed, they will show that a dramatic shift has taken place.

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

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

TABLE 8 -- Ratio of Yield on Long-term, Tax-exempt Municipal Securities to Yield on Long-term, Taxable Corporate Securities (1960-1975)
(Tax-exempt as a Percent of Taxable Yield)

Year	High Quality (Aaa) (Monthly Range)	Lower Quality (Baa) (Monthly Range)
1960	.717 - .757	.790 - .830
1961	.729 - .774	.774 - .819
1962	.680 - .726	.707 - .789
1963	.701 - .732	.725 - .748
1964	.678 - .717	.729 - .744
1965	.670 - .726	.715 - .753
1966	.698 - .736	.694 - .773
1967	.657 - .708	.658 - .712
1968	.664 - .709	.681 - .716
1969	.695 - .842	.730 - .817
1970	.682 - .826	.636 - .816
1971	.642 - .758	.634 - .737
1972	.673 - .725	.667 - .703
1973	.638 - .699	.631 - .694
1974	.642 - .748	.639 - .743
1975 Jan.	.724	.702
Feb.	.691	.674
Mar.	.724	.705
Apr.	.722	.719
May	.721	.715
June	.716	.720
July	.723	.736
Aug.	.715	.745

Source: Federal Reserve Bulletin, monthly indexes of daily data compiled by Moody's Investors Services.

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

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

Default would have a profound effect on New York City. Some city services could be temporarily disrupted if city employees, fearing that they will not be compensated, refused to work or if vendors and contractors refused to provide the city with goods and services except on a cash basis. The reorganization plan that would result from a default would probably call for an approximate balance between receipts and expenditures, a goal that according to current plans won't be attained until fiscal year 1978. This would be a difficult undertaking. The city's budget for fiscal year 1976 is $12.3 billion, with the deficit estimated at $726 million. At least one-third of this budget is comprised of items such as welfare, pensions, and debt service that are relatively uncontrollable. Balancing the city's budget would involve either massive cuts in employment and services in other areas or sizable increases in taxes. The city's dilemma is obvious. Cuts in employment and wage rates are likely to be unacceptable to the city's employees, while tax increases are likely to further erode the tax base. New York has managed to maintain a high level of public services only by running large deficits each year. It may be impossible to maintain these services on a pay-as-you-go basis when corporations and middle class taxpayers have the option of relocating to avoid higher taxation. On the other hand, from a political standpoint it may be impossible to cut these service levels.

A large expenditure cutback by New York City would have a noticable impact on the federal budget. Crude estimates suggest that were the city to balance its budget by cutting its spending by $726 million, the federal government's deficit could rise by somewhere between $300 million and $400 million. This would occur partially because federal tax receipts would fall when city and private sector workers lost their jobs because of the cutback and partially because these individuals and their families, to some extent, would rely on unemployment, welfare, food stamps, medicaid, and other benefits that are totally or partially supported by federal expenditures. Yet, it should be noted that such a cutback would represent net reduction of $200 million to $300 million in the total deficit of the public sector -- while New York's deficit would be reduced by $726 million, the federal deficit would rise by roughly half that amount. It should also be noted that both the city and state budgets would be impacted in a similar way -- tax revenues would fall while expenditures would be forced up. This suggests that a slightly larger cutback than $726 million would be needed to truly balance the city's budget.

VI. POLICY ALTERNATIVES

Four questions must be addressed in any discussion of the policy options for dealing with New York's financial crisis: First, what level of government should act? Second, what action should be taken? Third, who should bear the costs, if any, of the policy? Fourth, should the policy be tailored exclusively for New York or should it apply to a broader group of jurisdictions? The policy options open to each level of government -- New York City, New York State, and the federal government -- are discussed in turn.

New York City. At this advanced state of the financial crisis, few, if any, options remain open to the city acting alone. The only obvious course of action would be the immediate institution of draconian budget cuts and sharply higher taxes, so that the city would operate with a sizable budget surplus that could be earmarked for the rapid liquidation of the city's deficit related short-term debt. The three-year fiscal plan required by the Financial Emergency Act should encompass some actions along these lines. The difficulties and possible repercussions of this approach were discussed in the previous section.

The basic case for requiring the city to "save" itself rests on the widespread feeling that most of the "blame" for the city's current situation must rest with the past "irresponsible" behavior of city officials. Moreover, there is an understandable reluctance of persons from outside of the New York area to assist the city when their localities provide neither the range nor levels of services offered New York's citizens.

The basic reason for not requiring the city to attempt to "save" itself is that it is probable that nothing the city can do quickly and on its own would be sufficient to restore investor confidence. Balancing the budget by means of large service cuts and tax increases may be impossible from a political perspective. To a majority of New Yorkers, default may be a preferable alternative, one that may involve less drastic reductions in services and a more gradual increase in taxes. From the perspective of the investor who is being asked to loan the city capital over a long period of time, drastic fiscal reforms instituted by the city may not be credible. There may remain a fear that as soon as the spotlight of public attention had been turned off, the city would return to its old ways.

From a technical standpoint, it is unlikely that the city could make the sudden and drastic reductions in expenditures that would be required. Like the federal budget, much of the city's expenditures fall into the category of "relatively uncontrollable" (welfare, debt service, pensions, etc.). Significant reductions in overall spending would, therefore, require the gutting of many of the remaining "controllable," basic services and deep cuts in personnel. MAC has estimated that roughly 46,000 employees -- or 15 percent of the work force of the city and its semi-independent agencies -- would have to be laid off just to balance the budget. To accumulate a sizable budget surplus would require deeper cuts. Finally, a drastic reduction in services could undercut the local economy to such a degree that the welfare-related service demands placed on the city would be increased significantly and tax revenues decreased, thus counteracting some of the anticipated savings.

New York State. The state represents the second possible source of policies that could alleviate the city's fiscal crisis. The basic reason for advocating state action is that, traditionally and legally, the responsibility for dealing with the problems of cities, and local governments in general, has been a state one. Furthermore, several of the city's current problems can be traced to state policies. First, the state acquiesced to the budget "gimickry" that permitted the city to build up its huge short-term debt.

Second, and more fundamentally, the division of service responsibility between the city and the state has contributed to the long-run causes of the city's dilemma. Since some other states keep a closer reign on the fiscal behavior of their cities and most do not place such heavy welfare burdens on their cities, political leaders elsewhere are likely to view New York City's problems as primarily a state responsibility. To this case for state action can be added the probability that the state could initiate new policies sooner than could the federal government and that state policies would be better tailored to fit the special needs of the city than would be programs developed from a federal perspective. Already the state, through the Financial Emergency Act, has put in motion a strict program of fiscal reforms for the city, one that for all practical purposes shifts the locus of fiscal decision making from the city to the Emergency Financial Control Board.

The case against relying on the state to act is that it may be beyond the state's fiscal capacity or current ability. In fact, it has been argued that the city may well prove to be an albatross that brings down the state, forcing it to default as well. Already without assisting the city, New York State is expected to incur an operating budget deficit of over $600 million in fiscal year 1976. Furthermore, despite the Financial Emergency Act, implementation of strict or costly state measures to control the city's finances may be as politically infeasible as local reforms. The significant fraction of the state's voters who live in New York City may oppose harsh measures, while many of those living in the remainder of the state may be unwilling to support costly state assistance.

There are several conceivable types of action that the state might take to aid the city. First, should investors still be unwilling to purchase city or MAC securities in December, the state could extend additional amounts of aid to the city by borrowing in its behalf. As has already been mentioned, it is possible that this avenue may be closed if

investors begin to react to state securities as they have to city and MAC issues. The high rates of interest charged the state in September suggest that this process may be beginning. Of course the state need not borrow; it could raise its taxes sharply to generate the necessary revenue. However, to raise the $3.5 billion needed by New York City between mid-December and the end of the city's fiscal year would require roughly a one-third surcharge on all state taxes and fees.

The second approach that the state might take would be to assume the responsibility of one or more of the services currently being provided by the city. Welfare services are the most obvious candidate for such a shift in responsibility. Under federal law the state determines eligibility requirements and benefit levels; therefore, the city already has virtually no control over its welfare budget although it must pay one-fourth of the cost. State assumption of welfare-related services would provide the city with a net saving of some $900 million per year, more than enough to balance its budget. Furthermore, it would reduce the total spending of the city by roughly one-third. Of course, from the state's standpoint, the takeover of welfare would be more costly because Albany would have to assume the local welfare burden in the remainder of the state as well. All told this would add about $1.2 billion to the state budget.

The City University system is another candidate for a state takeover. Currently the city spends approximately $505 million for its four year colleges and graduate programs, 40 percent of which is contributed by state or federal aid. Therefore, a state takeover of the University would save the city roughly $300 million. The cost to the state of such an action need not be as great as the savings to the city if the state integrates the City University into the state education system and institutes its tuition and fee schedules. Moreover, in contrast to the situation with respect to welfare, the state would not have to assume a similar burden from other local governments because no other localities in the state support extensive systems of higher education. Mass transit, courts, pensions, and elementary and secondary education represent other service areas for which the state could either assume direct fiscal responsibility or contribute an increased amount of state aid.

It is important to realize that any of these alternatives would necessitate sharply higher state taxes. The net benefit to New York City's taxpayers would depend upon which service was assumed by the state and what mechanism was used by the state to raise the necessary revenues. It is possible to make city taxpayers worse off in an absolute sense with the state assumption of certain services. This possibility was demonstrated by the Fleischmann Commission's plan which called for state assumption of the fiscal burden of elementary and secondary education and imposition of a uniform state level property tax.[1]

1. Report of the New York State Commission on the Quality, Cost and Financing of Elementary and Secondary Education. (The Commission, 1972, Vol. I.)

The Federal Government. The federal government clearly has the resources to stave off a city default. It also has the clout to ensure that there is a real restructuring of New York's fiscal practices. As has been mentioned, any plan put forward by either city or state officials may be crippled by political considerations. Some fear that, despite the Financial Emergency Act, the environment that allowed the accumulation of $3.3 billion in deficits still exists; city and state officials will still be sensitive to these pressures and may be unable to devise and implement a plan that can balance the city's budget and reduce its debt.

The rationale for federal intervention rests on the belief that New York plays a vital role in the national and world economies and, therefore, its fiscal health is an issue that transcends the responsibility of any one state. Moreover, the possibility that the city's default would adversely affect national money markets and the economic recovery would seem to argue for federal policy initiatives. The arguments against federal action are three-fold: first, that it is not the place of the federal government to intervene in the detailed operation of a local government's finances; second, that on distributional grounds the federal government should not be helping an area with above average public services support those services when it does nothing for jurisdictions with less adequate services; and finally, that any federal policy would have to include many other units of local government and thus would result in too large an increase in federal government activity.

To date, the federal government has refrained from active participation in New York City's financial problems. Since the current stopgap solution provides relief only through mid-December, the federal government will have to decide soon whether to intervene actively in the next crisis, or remain in its present passive posture.

The present federal policy is one that could be continued. Chairman Burns has stated that the Federal Reserve System stands ready to lend money to banks which encounter cash-flow problems due to default on city or state bonds. This reduces, if not eliminates, the possibility that banks will fail in domino fashion as they try to meet their temporary cash demands. This policy and the existence of the Federal Deposit Insurance Corporation makes a "run" on banks holding defaulted bonds and notes extremely unlikely. As has been mentioned previously, default is likely to involve delayed payments rather than a total write-off of principal and interest. Banks which are large holders of New York City securities can, in the worst of circumstances, envisage a short-term cash flow problem.

Direct Assistance. Direct assistance in the form of a new grant or advance payment of existing grants, at most, would postpone the city's financial problems for a short period unless a massive grant designed exclusively for New York City could be legislated. Presently, the only new grant program which both would provide a significant amount of aid to New York and which has even the remotest chance of quick legislative approval is the Intergovernmental Anti-Recession Assistance Act of 1975 (S. 1359) which was passed by the Senate in July. This program would partially protect

New York City as well as other local governments and states from recession induced revenue shortfalls and expenditure increases. However, under current economic conditions this program, if fully funded, would provide New York with only $138 million, enough to cover one-fifth of its current deficit or its average short-term borrowing needs for two weeks.

Advanced payment of existing grant-in-aid monies (revenue sharing, Medicaid, state school aid, etc.) is also not likely to help out much. Secretary Simon estimated that at most, approximately $200 million could be advanced to New York City from federal programs.[1] Considering that the state has already advanced New York much of its state aid, this route to temporary fiscal salvation does not look promising at the state level either. In any case if New York City were advanced its federal grant monies, it is likely that other cities and states would demand equal treatment. If this were granted, the Treasury would be forced to increase its short-term borrowing and the interest associated with this action would add marginally to the federal deficit.

Purchase of New York City Debt. At present, the Federal Reserve System (Fed) is the only federal entity that could buy municipal debt without new enabling legislation. However, the Fed interprets its power to do so to be valid only in cases in which the problem is a temporary one and only when the Fed is certain of prompt repayment.[2] Since it is the Fed's opinion that neither of these two criteria is met by the New York City situation, it has not shown a willingness to provide assistance.

There are other federal or quasi-federal agencies that buy obligations and issue their own debt. FNMA and GNMA provide a secondary market for mortgages and mortgage commitments. The Federal Financing Bank (FFB) purchases the debt of some federal agencies as well as some nonfederal debt that has been federally-guaranteed. The FFB currently pays for these with money that it borrows from the Treasury at slightly over the market rate for Treasury bonds. None of these agencies can buy New York City obligations under current law.

1. Statement of Treasury Secretary William E. Simon, before the Subcommittee on Commerce, Consumer and Monetary Affairs, House Committee on Governmental Operations, June 26, 1975.

2. See the statement by George W. Mitchell before the Subcommittee on Commerce, Consumer and Monetary Affairs of the House Committee on Governmental Operations, June 25, 1975, for an explicit treatment of the Federal Reserve System's authority.

Federal purchases of New York City debt, whether by the Fed, some existing federal agency acting under new legislation, or a new federal agency, amounts to refunding the city debt by increasing the obligations of the U. S. Government.[1] Such a scheme has the attractive feature that the interest income from the bonds or notes issued would be taxable, thereby reducing the loss of federal income tax revenue associated with tax-exempt municipal bonds. The net cost to the federal government of a refunding operation that transforms New York city debt into federal debt would have three components: first, a gain due to the increase in tax receipts stemming from the taxable nature of the interest income on federal bonds; second, an "expected" loss due to the possibility that New York City may not repay the federal government; and finally, a gain amounting to any premium that the federal government decided to charge the city over the prevailing Treasury bond rates.

The cost to New York city would obviously be the Treasury bond rate plus any premium charged by the Fed or other agency. If the probability that New York City will have to delay or skip payments on its notes is high, the premium that would have to be imposed to make the program costless to the federal government might be fairly high. Even if this risk is ignored, the federal government may want to charge a relatively high premium to discourage other potential claimants on this refunding service. From the standpoint of the city, the resulting rates may be desirable since they would doubtlessly be lower than those currently being paid. Another advantage of a plan involving direct purchase of the city notes by the federal government would be that the loan could be maintained as a short-term obligation which could be shifted quickly back into long-term municipal bonds when investor confidence in the city was rebuilt. The period of intervention in the city's affairs by higher levels of government thereby could be minimized.

Bond Guarantees. Another policy option that is very similar to the refunding operation just discussed is federal guarantees for New York City bonds and notes. This option would involve no additional tax expenditure costs because the federal government receives no tax on interest income from New York City debt whether or not it is guaranteed. The extra expenditure in this option essentially would be an insurance premium, stemming from the possibility that the federal government might have to pay off New York City's debt if the city was unable to meet its obligations. Of course, the federal government could charge New York City for this guarantee in much the same way the FHA or FDIC charges its clients. But again, without assurances of fiscal responsibility, this surcharge might need to be quite high.

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1. Alternatively the Federal Reserve could finance such purchases by increasing the money supply.

Without any sort of premium charged for these guarantees, the market rate of interest on federally-guaranteed, tax-exempt bonds or notes would be significantly lower than the rate now paid by even the highest rated (Aaa) municipalities. Therefore, it could be expected that all jurisdictions would want to avail themselves of this guarantee unless rather stringent conditions were placed on those governments receiving the benefit. Yet, such restrictions might be viewed as inequitable, because fiscally "responsible" jurisdictions would be forced to pay higher rates than those that had proven to be "irresponsible" and, thus, received the guarantee.

On the other hand, if all jurisdictions could obtain the guarantee, there might be a dramatic increase in municipal borrowing since the demand by municipalities for funds increases as interest rates decline. This would increase the inefficiency already caused by the artificially low price paid by municipalities for capital. A guarantee "premium" or a requirement that federally-guaranteed debt be taxable or a combination of both would increase the cost of borrowing to municipalities, thereby reducing demand for this mechanism and counteracting any temptation to borrow for projects with a low rate of return.

It is important to realize that federal bond guarantees, an agreement to federally-refund New York's debt or other similar policies could provide large capital gains to present bondholders. New York City securities have been discounted by the market to the point that they now have tax-exempt yields of approximately 11 percent. The rate of return on federally-guaranteed, tax-exempt issues would be less than 5 percent. Hence, the market value of long-term New York bonds could roughly double as soon as either federal plan were put into effect. With capital gains (or reduced capital losses) on the order of $5 billion at stake, it is clear that the pressure for federal guarantees or refunding will be great from those who stand to benefit. One way of eliminating such gains -- if that were considered desirable -- would be to require that all New York City bonds be replaced with new issues that yielded a return of 5 to 7 percent after taxes on their purchase price (not face value). Of course, such a requirement would deny recent bond purchasers the profit most expected from risking their capital in a very uncertain security.

Reinsurance of Municipal Debt. Another suggestion for federal government action is the establishment of a federal reinsurance agency to guarantee all or part of the losses that bondholders would incur from default on state or local bonds. One current proposal would establish a federal insurance agency that would reinsure bonds that have already been insured by private bond insurance companies and insure bonds of state local assistance agencies.[1] It is the second of these provisions

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1. See S. 2372.

that would be relevant for New York City, since MAC fits the definition of a state local assistance agency. Since the proposal provides that insurance will be for only 75 percent of losses, it would amount to a partial guarantee of MAC bonds, but one that significantly reduces their riskiness. This reduced risk presumably would allow MAC to reenter the market and float bonds at lower rates of interest. This scheme would represent a less favorable alternative from the municipalities' standpoint than a bond guarantee in two respects. First, the municipality would have to set up a state local assistance agency to gain access to the federal guarantees; this would probably involve some loss of local control over finances. Second, partial guarantee of losses would result in higher rate of interest than a total guarantee. It should be realized that most of the discussion dealing with federal guarantees applies equally to federally-insured debt and visa versa. For example, federal guarantees can be partial and large capital gains could result from a reinsurance program.

Given the experience of the last ten years, during which time New York City has accumulated $3.3 billion in operating deficits, any decision to refund, guarantee, or reinsure city debts would probably be accompanied by some control -- directly or indirectly through the state -- over the city's expenditures and revenues. Without such control, this financial help might be considered a license for further deficits by city officials, and at the very minimum an invitation for other cities to build up deficits for the federal government to assume. Furthermore, federal intervention in the issues of local taxation and expenditures violate a long-standing tradition of separation of responsibilities. Therefore, the expected consequences of the *laissez faire* stance now taken by the federal government must be considered sufficiently serious to warrant changes in that stance and the inevitable federal involvement in New York City's politics and budgetary decisions.

Shifting Financial Responsibilities. A final set of policy alternatives that could help New York City would be to shift some major fiscal responsibility now borne by the city to the federal government. The most frequently mentioned options along these lines are a federal takeover of welfare and replacement of the Medicaid system with a National Health Insurance Program. Realistically, these alternatives must be looked upon as options that could assist the city over the long run but could not provide salvation from its immediate problems. Any effort along these lines would entail complex nation-wide shifts and would involve higher federal taxes.

Summary. The policy alternatives have been discussed in this report, but they could, of course, be combined with each other to form a package of programs that would assist the city. In fact city, state and federal programs that individually might offer inadequate assistance can be grouped together in ways that provide realistic solutions to the

city's immediate dilemma. There are a large number of conceivable combinations that could be constructed from the alternatives listed in the chart below. One illustrative possibility would be to establish a system that requires:

- the city to reduce expenditures, raise taxes and conform to the other strictures of the Financial Emergency Act,
- the state to gradually, over a five-year period, assume the full local fiscal burden for welfare-related programs and,
- the federal government to establish a new taxable, federally-guaranteed class of municipal bonds that would be issued to cities through state governments which would be required to certify that the recipient of the guarantee was reforming its fiscal practices and adhering to a strictly balanced budget.

City	A. Expenditure reductions B. Tax increases C. Adoption of sound fiscal practices D. Management reforms and increased productivity
State	A. Increased direct aid B. Borrowing in behalf of the city C. Assumption of the fiscal responsibility for some major city service (e.g. welfare, the university, etc.)
Federal	A. Direct aid (e.g. Anti-recession Act, increased general revenue sharing, etc.) B. Direct loans C. Bond guarantees D. Bond insurance or reinsurance E. Assumption of the fiscal responsibility for some major city service. (e.g. National Health Insurance, Welfare Reform, etc.)

VII. CONCLUSION

The focus of this paper has been largely on the immediate crisis facing New York City and the alternative policy responses to this situation. However, the crisis will only be delayed temporarily unless the underlying causes of the city's fiscal difficulties are addressed. While it may be comforting to believe that these problems can be handled by the city alone, this probably is not the case. Certainly efficient management, strict accounting procedures, and the introduction of new technology can help, but such measures alone will not balance New York's budget and pay off a substantial portion of its accumulated short-term debt. Substantial service cutbacks and tax increases will be required to accomplish these objectives. Yet such actions will make the city a less attractive place in which to live and probably will hasten the exodus of middle- and upper-income families and commercial and industrial establishments. This, in turn, will undercut the city's ability to support even a reduced level of services.

Given these forces, it is probable that the underlying problems facing New York, as well as a number of other large, aging cities, can be dealt with effectively only by the states or by the federal government. Unless one is willing to consider policies that would redistribute the low-income populations now concentrated in central cities among suburban and rural jurisdictions, or policies that would radically equalize incomes, the main alternative left for addressing the cities' problems is to relieve the city of some major portions of its current fiscal responsibility. As has been mentioned previously, New York City's situation would be aided immensely if the state or the federal government assumed the burden now borne by the city for welfare and related services to the poor.

Congressional Budget Office
Background Paper #1
October 10, 1975

NEW YORK CITY'S FISCAL PROBLEM
ERRATA SHEET-PAGE 12-TABLE 5

TABLE 5--The New York City Tax Burden

Fiscal Year	Personal Income ($ billions)	Taxes* ($ billions)	Taxes as Percent of Personal Income
1963-64	27	2.013	7.6
1964-65	28	2.193	7.9
1965-66	29	2.152	7.3
1966-67	31	2.410	7.7
1967-68	34	2.626	7.8
1968-69	37	2.802	7.6
1969-70	39	2.958	7.5
1970-71	41	3.178	7.7
1971-72	43	3.736	8.7
1972-73	45	4.017	8.9
1973-74	48	4.506	9.4
1974-75	50	5.111	10.2

Source: New York City Finance Administration

*Excludes fees and charges, stock transfer taxes and nonresident income taxes.

EMBARGOED FOR RELEASE:
UNTIL 6:00 p.m, OCTOBER 11, 1975

OCTOBER 11, 1975

Office of the Vice President
New York, New York

file

REMARKS OF THE VICE PRESIDENT
AT THE
ANNUAL COLUMBUS DAY DINNER
THE WALDORF-ASTORIA HOTEL
NEW YORK, NEW YORK

October 11, 1975

Columbus Day in New York is always a high point in the year. Coming in mid-October, it heralds the onset of the magnificant fall season in our area with its brisk, invigorating weather and the marvelous color throughout the countryside.

More importantly, Columbus Day is a special day -- special because it commemorates not only the birth of the Great Discoverer but celebrates the generations of Italo-Americans who have contributed so much to this America.

In business, in finance, in labor, in science, in education and the arts, government and politics, Italo-Americans have added to the strength, the vitality and the ennoblement of our way of life.

Columbus Day marks not only these achievements, but recognizes the warmth, the enthusiasm, the generosity and great humanity of those of Italian origin. It pays tribute, too, to their spiritual dedication and their intense patriotism.

It was the spirit of Columbus -- seeking of a new world -- the seeking of opportunity, that brought Italian immigrants here and that motivates their descendents today.

As we celebrate this Columbus Day, it is well to remember also that Christopher Columbus challenged the popular thrust of his day -- the belief that the world was flat.

At a time when opinion was overwhelmingly against his insight and view, Columbus took the unpopular course. He did so because it was what the best informed minds and most knowledgeable observers counseled. He did so because it was the sound way -- and his courage was more than vindicated.

This is a time, too, when leadership again faces unpopular action if we are to pursue a sound course for the future.

Pesident Ford faces it continually in the difficult role of combating inflation and the politically unpopular actions required to hold down the persistent pressures for more federal spending -- with a $60 to $70 billion federal deficit this year.

- more -

Governor Carey, Mayor Beame and the Emergency Financial Control Board face it in the difficult and also politically unpopular decisions involved in restoring fiscal soundness to New York City. Yet, such steps have to be taken to restore confidence and engender outside support.

A central fact, not fully appreciated in this connection, is that the President of the United States does not have authority under existing statutes to meet the situation.

As we know, under the State law adopted by the Legislature on September 10, and signed by the Governor, New York City must come up by next Thursday, October 15, with a budget and financial plan which will produce a balanced budget by June 30, 1978.

This plan must be based on the realistic estimate of revenues provided to the City by the State Emergency Financial Control Board.

The Control Board must either approve, disapprove or modify the City's plan by October 20 to accomplish these objectives.

The City must take the action required to implement this plan.

When the necessary actions are taken and a solid base is established for restoration of budgetary and fiscal integrity for the City, it is my belief that at this point a basis will have been established for help to bridge that difficult period -- between the adoption of the necessary measures required by the State Emergency Financial Control Board this October and the restoration of investor confidence in the City's full financial viability by June 30, 1978. In other words, when the Control Board and the City have enacted these difficult measures, the essential preconditions will have been met and the stage set for appropriate Congressional action.

It is, therefore, essential that the Congress as a whole focus on the problem now and enact appropriate legislation.

Helping to bridge this gap -- to give opportunity for these economies and improved management measures to take root and produce results -- is certainly in the interest of all of us.

While there is general agreement that management deficiencies contributed to New York City's difficulties, it is important that we not lose sight of the burden carried by New York and the other cities of the nation as they have sought to respond to human needs pressed upon them.

It is equally important that these past responses be viewed in the context of their times -- times when we were being told we were an affluent society with unlimited resources that could abolish poverty by statutory fiat.

The stark facts of today show that we have been promising more than we can deliver -- that we have been raising expectations beyond our capacities to meet them.

As a result, we are now compelled at all levels of government to take stock of our commitments and our resources, in order to project a more realistic course to meet the people's needs.

In this appraisal, the plight of our cities requires special attention and emphasis. This nation has too long ignored the basics for urban living -- the need for an infrastructure that provides a climate for real jobs, for business, for the economic health and the social well being of the urban areas of America where most of our people now live.

(MORE)

Time is of the essence and the resolution of this immediate New York City situation is crucial. After the Control Board and New York City have acted to restore fiscal integrity, it will be a true test of the responsiveness of our Congressional system as to whether the Congress can act in time to avoid catastrophe.

These are difficult times, demanding hard decisions and effective actions.

But out of them can come a new urban vitality -- built upon sound fiscal and social policies and a recognition and appreciation of the dynamic economic and cultural role of urban America.

# # #

NYC file

NY City

10/17/75

Peter Goldmark

Situation

~~No change in~~

1) Teachers argument

Shanker - election w/

Gov Shortly

2) VP - Action

Would call Shanker

if he wants

to -.

477-2706

[Oct. 17, 1975]

File New York City

Q That stuff is irrelevant since it is changed.

MR. NESSEN: I thought what I was asked ~~to~~ do was come here and state the President's view, which is that he doesn't have any plan -- and I can tell you flatly -- he doesn't have any plan to take action to prevent a New York City default.

First of all, he doesn't believe he has the authority to provide any long-term aid to New York City and even if he did he wouldn't do it because he doesn't believe that any quick infusion of a few million dollars is going to solve the long-term problems of New York City. Those problems can only be solved by the mayor and his officials and by the Governor and the State officials.

Q Mayor Beame is going to be in town over the weekend, and I think next week, testifying before Congressional committees. Are there any plans for him to meet with the President?

MR. NESSEN: As far as I can find out, Mayor Beame has not requested any meeting at the White House.

Q He wanted to speak with the President last night when he called. Has the President himself spoken to Mayor Beame or anyone else in New York?

MR. NESSEN: Not today.

Q Ron, how did the Vice President know roughly an hour before the Shanker announcement was on the UPI wire?

MR. NESSEN: I have spent a lot of time checking this out.

I guess we don't need the film for this.

Q Why not?

MR. NESSEN: I don't mind.

I spent about an hour checking this out and let me tell you how it comes together, if you will. Let me do it chronologically, if I may.

Some time before 9:00 this morning, Peter Goldmark, who is the Budget Director for New York State, telephoned Jim Cannon. He called Jim Cannon because he was unable to reach Dick Dunham, who would have been his normal contact on the monitoring team the President has set up to watch carefully the developments in New York City.

Peter Goldmark told Jim Cannon that it looked like Albert Shanker was not going to do anything but that Governor Carey had called Shanker to come to the Governor's office in New York City to discuss the situation.

Goldmark also told Jim Cannon that he hoped it was possible perhaps to get some relief from Levitt, who is the State Comptroller and the trustee for the State Pension Funds.

A short time after that conversation, Goldmark did get directly in touch with Dunham and told him the same thing.

At about 10:00, Jim Cannon had to go to the Vice President's office to discuss a number of subjects with him and one of the things he said was this is a crucial day for New York City. He then related to the Vice President the conversation he had had with Goldmark during which Goldmark said it didn't look like Shanker was going to do anything, but the Governor had called him to the office and so forth.

At about 1:15 or 1:30, the Vice President was asked some questions at his house during a reception, and I think you know what he said at that time.

I called the Vice President just about 15 minutes ago, I think, and he says that he was simply confused in what he said at his house between 1:15 and 1:30; that what he said was based on his conversation with Jim Cannon at 10:00 this morning and that he thought that what Jim Cannon was relaying to him, from the phone conversation with Goldmark involving Shanker, had been told directly to Cannon by Shanker.

Q What is the President's position right now regarding the possible veto of legislation that might come out of the Congress?

MR. NESSEN: The President has looked at about six or eight different ideas that have been proposed for legislation and proposed by both Members of Congress and people outside of Congress, and the President simply has not seen anything in those six or eight proposals that he believes would help or would be worthwhile and, in fact, he sees most of them as being harmful.

Q You say most of them?

MR. NESSEN: I am sorry, he thinks every one of them -- the President has not seen any piece of proposed legislation that he believes would be helpful.

from Osborn Elliott

Jim Cannon

FYI -
against your
advice!

GF

CITIZENS COMMITTEE FOR NEW YORK CITY

File

Statement by Osborn Elliott, Chairman,
Citizens Committee for New York City,
Before the Economic Stabilization
Subcommittee of the House Banking
Committee

October 20, 1975

My name is Osborn Elliott. I am editor-in-chief and chairman of the board of Newsweek, and I have recently been named chairman of the Citizens Committee for New York City.

All my working life I have been a journalist, and this profession has rewarded me in many ways--including the luxury of being able to stand a bit back from events, and watch them unfold. On only rare occasions have I felt obliged to take a stand, except in the privacy of the voting booth. Because of my profession, I have never served on a jury. And certainly I have never, until now, appeared as a witness before any public body.

I am here today, not as an executive of Newsweek, nor as an expert on urban affairs, but as a mightily concerned citizen of New York City. I was born in New York, and so were my children, my parents, all of my grandparents, and some of their parents as well. As Casey Stengel would have said, you could look it up. Last week my 85-year-old father, a resident of New York City for all his life, showed me a city directory of 1856, listing <u>his</u> two grandfathers--one of whom was a wholesale grocer, the other a banker, in my home town.

For me to depart from my accustomed journalistic detachment represents a very big change, and I have not come by it easily. I have told our staff at Newsweek that I shall not be involved in any of the magazine's coverage of New York City affairs, so long as I am chairman of the Citizens Committee.

Why have I moved, uncharacteristically, into the public sphere? Why am I testifying here today?

Because, quite simply, I am deeply concerned about the condition of my city, and about the possible impact of its plight on the rest of the country, not to mention the world.

The Citizens Committee for New York City, Mr. Chairman, has been formed for the purpose of helping New Yorkers help themselves--in making their city a better place to work, live and invest in. Our franchise is as big and broad as the city itself, and as small and finite as any one of its thousands of individual blocks.

In the broadest focus, we citizens want to maintain and improve the economic base of New York, by attracting businesses to the city and encouraging those who are already there to stay--and we want the world to know that New Yorkers care about New York.

In the narrowest focus, there are 6,000 block associations in New York, full of dedicated people, and we plan to encourage them and stimulate them and inspire them to improve the quality of life in their neighborhoods.

Our committee, while initiated by Senators Javits and Buckley, is non-partisan and non-political. Its honorary vice-chairmen include the Governor, the Mayor, the state controller and the chairman of the New York delegation in Congress. Now about 200 strong, it includes whites and blacks and Puerto Ricans, Catholics, Jews and Protestants, rich and poor, Democrats, Republicans and independents like myself. It also represents a broad cross-section of the city's leadership--in labor, business, education, religion, communications, civil rights, and the arts. Just to mention one member from each of these fields: Harry van Arsdale (labor); Douglas Dillon (business); John Sawhill (education); Bishop Paul Moore (religion); Robert Sarnoff (communications); Vernon Jordan (civil rights); Thomas Hoving (the arts).

Our committee is at this moment incorporating, and seeking tax-exempt status. We have just this morning engaged an executive director, and our staff will be small. But this small staff will be drawing on the vast resources of New York to bring them to bear on the vast problems of New York.

Our goal is not alone the short-term business of dealing with the city's immediate financial crisis; we are here to stay, and if default should befall our city, so much greater the need for a self-help program of the sort we have undertaken. But at the same time, we are naturally concerned about the immediate future, and distressed at the evident hostility among certain members of the current administration, and their callous view that eight million--or 15 million--people should somehow prove themselves in a trial by fire.

We are equally concerned about the evident animosity toward New York City around the country--an animus against this city that has been the port of entry for so many waves of immigrants from abroad and from our own midst, for so many years.

New York City has borne unique burdens as a result--including the onus of its current image, in the minds of so many Americans, as a place of pushers, pimps, prostitutes, welfare rip-pffs and con men of every stripe.

But this, we New Yorkers know, is not the true picture of New York. Most of us are people committed to our city, and to the wellbeing of our families. And some of us worry about how much of the current hostility represents an ugly residue of anti-black, anti-semitic, anti-Puerto Rican, anti-poor-folks knee-jerkism that is still so unfortunate a presence in our national psyche.

Who suffers from a New York City default? All New Yorkers do--but in particular those who have already suffered so much. The working mother who loses the day-care center that now enables her to go out and earn a living. The person who is just now breaking out of whichever ghetto into a different, better neighborhood and job--but who is now denied so many basic hopes for better education, health and safety for his family.

Who else suffers? The citizens of New York State at large, if its credit also crumbles and its towns and counties and cities are denied access to the money markets.

No one knows for sure--but it seems to me that if New York is crippled, the plague will likely spread--to Connecticut, Massachusetts, Michigan, Indiana, Missouri, Ohio, and points North, East, South and West. We may see the rebirth of polio--polio of the body politic.

Our Citizens Committee is well aware of the many glories of New York--its operas, its museums, its libraries and parks, its educational and business institutions, that make it the financial capital of the world. And it is not by accident that so many of our leading businessmen, artists and writers and dancers and other innovators are attracted to this vibrant city, or rely on it for their work.

We are also aware of our city's many miseries--its poverty and crime and vandalism and, in many areas, its sense of utter hopelessness--as an inequitable welfare system too often destroys the spirit of both those who work, and those who do not.

The Citizens Committee for New York believes that the city must be relieved of its huge welfare burden.

We also believe that the Federal government must also come to the aid of the city, with loan guarantees or other devices, to enable it to sell its bonds again.

The Citizens Committee for New York City also recognizes, Mr. Chairman, that New York has been badly run for years--and we will bend every effort to see that its affairs are put in order.

What we citizens expect to do is to make our city's excellences--its extraordinary human and other resources--work to eradicate its ills.

But this operation cannot be successful if, in the meantime, the patient is allowed to wither by Federal neglect.

* * * *

[1975]

THE WHITE HOUSE
WASHINGTON

Date: 10-23-74

TO: Cannon

FROM: Max L. Friedersdorf

For Your Information ✓

Please Handle ____

Please See Me ____

Comments, Please ____

Other

10-23-75

THE WHITE HOUSE
WASHINGTON

TO: MAV

FOR YOUR INFORMATION ✓

FOR APPROPRIATE HANDLING

PER YOUR REQUEST

The Buckley Press Conference.

Bill

WILLIAM T. KENDALL

BUCKLEY NEWS BUCKLEY NEWS BUCKLEY NEWS
FROM THE OFFICE OF SENATOR JAMES L. BUCKLEY, NEW YORK • LEONARD SAFFIR
PRESS SECRETARY
(202) 224-4451

FOR IMMEDIATE RELEASE
THURSDAY, OCTOBER 23, 1975

New York City

SENATOR JAMES L. BUCKLEY
STATEMENT ON NEW YORK CITY
OCTOBER 23, 1975

What I am about to say has no connection whatever with my views as to the measures that must be taken to place New York City back on its feet. The problem we all face is to determine how best to help the City out of its current crisis, and we cannot allow our judgments to be colored by past history except as a guide to practices that must be avoided in the future.

With respect to my own position, now that reasonably accurate figures have become available as to what we can expect in terms of income and economies over the next three years, my own views on what specifically needs to be done in the interest of the people of both New York City and the State are beginning to crystallize, and I will have something to say about them next week.

Senator Ralph J. Marino, Chairman of the New York State Select Committee on Crime, has forwarded to me a copy of a memorandum prepared by Committee Counsel Jeremiah B. McKenna regarding certain aspects of the current New York City fiscal crisis. Senator Marino referred the matter to me because of his belief that certain grave allegations detailed in the memorandum, including possible violations of federal law, should be made the subject of investigation by appropriate federal agencies.

After examining the State Comptroller's Interim Reports on New York City's central budgetary and accounting practices, Mr. McKenna stated: "These reports leave little doubt that recent City borrowings have relied upon massive fraud in the statement of the accounts pledged to repay the borrowed funds. The issue of immediate concern is whether such municipal fraud is inadvertent or deliberate." The Comptroller's Report, according to Mr. McKenna, "is strewn with comments that cry out for further investigation..." Mr. McKenna goes on to report that "the City has been pyramiding its fictitious accounts receivable, tied to Federal and State Revenues, into a concealed deficit in the hundreds of millions..." and that "The City was enabled to illegally increase its debt limit, understate its true tax rate and permit its budget to appear to be in balance when in fact it was seriously out of balance."

The memorandum cites the following facts, among others, in support of these allegations, all of them based on an examination of the State Comptroller's Reports:

"The State Comptroller's Office looked at the Receivables from State and Federal governments applicable to the years ended June 30, 1974 and June 30, 1973. Interim report No. 1 states the result of audit succinctly: "We examined $373.3 million out of $434.2 million of such Receivables, and found them to be overstated by $324.6 million."

"Between September 11, 1973 and November 12, 1974, the City issued $1,275 million in Revenue Anticipation Notes against a declaration of $1,667 million in anticipated State and Federal aid receipts. The actual anticipated aid receipts in the City's books of account were $1,016 million but most significantly the actual realizable aid was $404million."

"When Arthur Levitt's auditors examined in detail the $502 million of uncollected real estate taxes, they found that $408 million out of the $502 million were uncollectable. The City borrowed $308 million in tax anticipation notes on June 11, 1975 pledging these uncollectable tax revenues as collateral."

Mr. McKenna concludes: "If the false entries concerned with anticipated State and Federal receipts were knowingly used in any reports filed with a federal agency, it would appear that Section 1001 of Title 18 of the U.S. Code would make such a federal crime... If there are public officials who are criminally responsible for the financial calamity that now threatens the City, State, and indeed, the nation, their individual responsibility should be fixed and fixed quickly."

These statements are of a most grave and serious nature and require a speedy investigation. I am therefore writing to President Ford to urge him to initiate a Justice Department investigation to determine if there have been any violations of Federal Law. I want to emphasize that in doing so, I make no judgment whatsoever as to whether Federal laws have been broken. Nor have I any. I believe, however, that both the nature and the extent of the questions raised by the McKenna memorandum require a complete examination.

I am also writing the Chairman of the Senate Banking Committee to recommend that this matter be examined on an urgent basis to determine what reforms in federal laws, as they relate to the interstate sale of municipal securities, might be required in light of the New York City experience. It seems clear from the McKenna memorandum that billions of dollars of City notes and bonds have been sold on the basis of incredibly deficient financial information. In the light of these disclosures, the future health of the market for municipal securities may well depend on a tightening of the federal laws governing their interstate sale.

The matters touched upon BY the memorandum forwarded to me by Senator Marino reflects only one aspect of the unfolding New York City story. It is one that clearly has federal implications. Moreover, a great many witnesses representing the City and State government, governments of other states, and the financial community have testified before various congressional committees in recent weeks to the effect that the chronic mismanagement of New York City has set in motion forces that threaten to have a national impact of the most serious dimensions. While I question these conclusions, I think it is clear that there is a critical need for a thorough study of the origins of the current New York City fiscal crisis so that the nation may have a better understanding of its causes and possible effects.

If such a study is to be meaningful, it must be removed from the realm of City, State, and partisan politics. I therefore intend, at an early date, to introduce legislation calling for the establishment of a non-partisan commission with full powers of subpeona to make the necessary investigation. Such a study should prove invaluable to the public and to municipalities across the country.

If institutional reforms are required, if new adjustments must be made in the relationships between the various levels of government in our federal system, their responsibilities and financing, the time to make the evaluation is now. If the problems faced by New York City are indeed endemic, we need to make the appropriate decisions in an atmosphere not so overladen with crisis that we find ourselves propelled into short term expedients that can produce long term damage to the federal system.

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NEW YORK STATE
SELECT COMMITTEE ON CRIME
ITS CAUSES, CONTROL AND EFFECT ON SOCIETY
270 Broadway
New York, New York 10007
Area Code 212 488-3545

Members of Committee

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Chairman of Ways & Means
Committee of Assembly

Jeremiah B. [illegible]
General Counsel

Ref. ________________

October 16, 1975

Hon. James Buckley
17 Russell Building
Washington, D. C. 20510

Dear Senator Buckley:

Enclosed is a memorandum prepared by the counsel to my committee in which he raises issues of grave concern that relate to the New York City fiscal crisis. The recommendation is made that the issues raised in the memorandum be brought to your attention with a view to perhaps mobilizing the appropriate federal response.

I fully concur in such recommendation and accordingly forward the memorandum to you for whatever action you deem appropriate. Please be assured that both I and my committee's staff stand ready to answer any inquiry or assist in any way should you wish to pursue this matter further.

Very truly yours,

Ralph J. Marino

Senator Ralph J. Marino
Chairman

RJM:ehc
Enc.

NEW YORK STATE
SELECT COMMITTEE ON CRIME
ITS CAUSES, CONTROL AND EFFECT ON SOCIETY
270 Broadway
New York, New York 10007
Area Code 212 488-3545

MEMORANDUM

TO: SENATOR RALPH J. MARINO, CHAIRMAN

FROM: JEREMIAH B. McKENNA, COUNSEL

DATE: October 13, 1975

INTRODUCTION

Pursuant to your request we have examined the State Comptroller's Interim Reports 1 and 2 which concern New York City's central budgetary and accounting practices. These reports leave little doubt that recent city borrowings have relied upon massive fraud in the statement of the accounts pledged to repay the borrowed funds. The issue of immediate concern is whether such municipal fraud is inadvertent or deliberate.

THE FACTS: INTERIM REPORT NO. 1

The first report, designated Report No. NYC-3-76, focused upon the Supplementary Revenues listed as Receivables from the State and Federal governments. These comprise 38% of the City's Expense Budget. A portion of these funds are advanced or paid quickly to the City but inevitably some payments lag behind the City's expenditure of these funds. This creates a built-in need for short term borrowing by the City to enable it to make the expenditure in advance of reimbursement. Such borrowing usually occurs in the form of Revenue Anticipation Notes (RANs).

The State Comptroller's Office looked at the Receivables from the State and Federal governments applicable to the years ended June 30, 1974 and June 30, 1973. Interim Report No. 1 states the result of the audit succinctly:

> "The accounts receivable from the State and Federal governments applicable to the years ended June 30, 1974 and June 30, 1973, recorded in the City's central fiscal records as of March 31, 1975 are grossly overstated. We examined $373.3 million out of $434.2 million of such Receivables, and found them to be overstated by $324.6 million." (at p.2, emphasis supplied.)

The Comptroller's Report is strewn with comments that cry out for further investigation. For example, it was the practice of the City Comptroller's office to send city agencies a statement listing the balance of the State and Federal receivables that pertained to the agency's programs. In one instance, the city agency involved, the Department of Social Services, responded by declaring $121.4 million "no good" and explaining why.[1] Nevertheless, the item remained a receivable in the Comptroller's records.

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1. Office of the Comptroller of the State of New York, Report on New York City's Central Budgetary and Accounting System, Report No. NYC-3-76 pp. 17-18, 1975.

Between Spetember 11, 1973 and November 12, 1974, the City issued $1, 275 million in Revenue Anticipation Notes against a declaration of $1, 667 million in anticipated State and Federal aid receipts. The actual anticipated aid receipts in the City's books of account were $1, 016 million but most significantly the actual realizable aid was $404 million.[2.] When the anticipated revenues did not come in because they were fictitious, the City drew from other sources to repay the note holders on the due dates. For example, on September 16, 1974, two (2) RANs, totalling $500 million, became due which the City paid from an issue of current RANs.[3.] Thus, the City has been pyramiding its fictitious accounts receivable, tied to Federal and State Revenues, into a concealed deficit in the hundreds of millions.

There are other ramifications to this particular manipulation of the City's accounts receivable. The City was able to circumvent the requirement of a balanced budget and incur expenditures without offsetting revenue sources. The City was simultaneously able to report better year-end results than actually experienced.[4.] The inflation of the anticipated Federal and State aid also relieved the pressure

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[2.] Ibid, p. 26
[3.] Ibid, p. 26
[4.] Ibid, p. 27

on the rest of the expense budget by raising the revenue side of the ledger and reducing the expense side.

THE FACTS: INTERIM REPORT NO. 2

The New York City Charter section 1515 provides that after expenditures have been matched against receipts, the budget is to be balanced by the real estate tax levy. For the year ended June 30, 1975, the expense budget of $11.1 billion was to be financed in part by a real estate tax levy of $2.9 billion. But included in the anticipated real estate tax revenues were $502 million in uncollected real estate taxes.

When Arthur Levitt's auditors examined in detail the $502 million of uncollected real estate taxes, they found this amount included $126 million on diplomatically owned and therefore untaxable real property, $53 million on Mitchell-Lama housing for which tax abatement had been granted, $54 million for property on which the City was in the process of foreclosure for delinquent taxes and $43 million for property belonging to the bankrupt Penn Central Railroad for which there was little likelihood of payment in the foreseeable future. When it was added up, some $408 million out of the $502 million was uncollectible.

The City borrowed $308 million in Tax Anticipation Notes (TANs) on June 11, 1975 pledging these uncollectible tax revenues as collateral. There were other effects from the inclusion of these fictitious tax receivables in the City's revenue budget. The City was enabled to illegally increase its debt limit, understate its true tax rate and permit its budget to appear to be in balance when in fact it was seriously out of balance.

THE APPLICABLE LAW

Section 175.30 of the Penal Law makes it a Class A misdemeanor to present to a public servant or office a written instrument containing false statements or information with the knowledge that it will become part of the records of such public office. The City's budget, its accounts receivable and the documents supporting the issuance of the various Tax Anticipation Notes and Revenue Anticipation Notes qualify as instruments for purposes of this section. If an intent to defraud the State or City can be shown, the crime is raised to a Class E felony by Penal Law Section 175.35. In addition, Section 175.45 of the Penal Law makes it a Class A misdemeanor to issue false financial statements in the manner detailed in the Interim Reports Numbers 1 and 2. The issue to be decided is whether the false entries in the City's fiscal records were made inadvertently or deliberately. If these entries were knowlingly and deliberately made with an intent to conceal the true financial condition of New York City and to permit the City to borrow to meet its cash needs under a budget dangerously out of balance, then it would appear that Article 175 of the Penal Law applies.

FEDERAL STATUTES

If the false entries concerned with anticipated State and Federal receipts were knowingly used in any reports filed with a federal agency, it would appear that Section 1001 of Title 18 of the U. S. Code would make such a federal crime. In addition, Section 1014 of Title 18 of the U. S. Code makes it a crime for anyone knowingly to make a false financial statement or overvalue any security for the purpose of influencing the action on a loan of a bank insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation. If the RAN or the TANs mentioned in the Comptroller's reports were purchased by FDIC or FSLIC insured banks, and it can be shown that the gross overstatement of the anticipated Federal and State revenue accounts receivable and the real estate tax receivables was deliberate, then it would appear there is federal criminal jurisdiction over the fiscal record manipulations of New York City.

CONCLUSION

There is little doubt that this Committee has the jurisdiction to investigate to determine whether public officials of the City of New York have knowingly participated in one of the most mammoth financial frauds in history. Unfortunately, our Committee has neither the resources nor the staff to conduct such an investigation properly. If either our Committee or the Senate Finance Committee undertook this investigation singly or jointly, we would be accused of political partisanship. Such a crucial investigation as this should not be impeded by charges of partisanship, however false they may be.

It appears then that the investigation could best be conducted by a federal agency that would draw upon the resources and trained staff available on the federal level. It is therefore our recommendation that this problem be referred to U. S. Senator James Buckley so that he might explore through his office which federal agency or vehicle would be most appropriate for this investigation.

If there are public officials who are criminally responsible for the financial calamity that now threatens the city, state and, indeed, the nation, their individual responsibility should be fixed and fixed quickly.

JBM:ehc

THE WHITE HOUSE

WASHINGTON

October 23, 1975

TO: DONALD RUMSFELD

FROM: JERRY JONES

SUBJECT: Forums for Presidential Message on New York City

Dick asked for a layout of the possible forums on Monday, Tuesday and Wednesday of next week for the President to deliver a message as to his position on New York City's financial crisis. Unfortunately, the options are rather limited; the following is the entire range that Bill, Red, Terry and I have been able to develop:

1. A forum in New York City on Wednesday morning on the way to Los Angeles. The standing forums are as follows: the Investment Association of New York -- 650 members under the age of 41; the National Alliance of Businessmen in New York City; Columbia Business School Club; New York Society of Security Analysts which the President appeared before in February of this year.

The benefits of a New York forum are that the President takes on the problem in the lion's den; the down side is a travel issue, a potential demonstrator problem and the lack of a truly appropriate forum to address the humanitarian side of this problem. In addition, Mayor Beame would probably want to greet the President and this could not help but be an embarrassing situation.

2. Reschedule the luncheon speech in Albuquerque in front of the Western Governors. There will be ten Democratic governors at this conference, the subject of which is energy. The governors would probably support the President's position on New York. However, the down side problems are: (a) Rescheduling a canceled event adds to the disorganization charge; (b) addressing the New York City problem in front of Western governors may not be appropriate; (c) the conference topic is energy.

NO

3. Deliver the message in a speech at the Los Angeles fund raising dinner. While this gets the President's position in front of the public it is bad form because it is a partisan function, it is in Los Angeles, it is in front of fat cats, we lose the news cycle because of the late hour on the East coast.

4. Deliver the message at the San Francisco fund raising function. Same as above except you do make the East coast news cycle on Thursday.

5. A function in Washington, D.C. This would be the best except there are no appropriate forums the first three days of next week. The following groups are in town: (a) the beauticians (b) American Institute of Aeronautics (c) National Council of Jewish Women (d) Girl Scouts of America (e) Air Traffic Control Association (f) Railway Progress Institute and several others of like quality. In addition, Baroody currently does not have a large group coming in next week. If we create an event by inviting mayors or governors or some other appropriate group the down side is the charge of media manipulation and at this late date it would be difficult to avoid that problem.

NO

6. Ask for network television time to deliver a speech to the nation. While this would be the best possible option in terms of getting the President's position well stated to the country, we believe that the networks would not grant the time request and that the topic in reality is not of sufficient importance to risk the second consecutive turndown on a time request.

7. Address a joint session of Congress on Wednesday morning. We believe that such an address should be limited to major national issues of over-riding importance. This is not one and we feel such a request would be an over-reaction to the problem and thus be a political minus.

8. Send a written statement to the Congress and make a brief statement for film on the New York City problem on Tuesday morning or Wednesday morning. Because of the lack of an appropriate forum in Washington this is our recommended option. The brief four or five minute statement can be made either from the Oval Office or in the press room and if it is properly worded it will generate the same television exposure of any of the above options with the exception of the nationwide television address. We also feel that this type of response is the most "Presidential." It does not involve travel, it does not involve theatrics, it is not an over-reaction to what is not actually a national problem and it gets maximum exposure with minimum inconvenience.

Therefore, we recommend Option 8.

_______Approve _______Disapprove

October 20, 1975

NEW YORK CITY

Events are now rushing to an apparent climax in the financial affairs of New York City. Five days ago the city tottered on the brink of a default and was saved from that fate by an eleventh hour decision of the teachers union.

The next day, Mayor Beame testified here in Washington that the financial resources of the city and of the State of New York were exhausted. Governor Carey agreed. It's now up to Washington, they say. Unless the Federal Government intervenes, New York City will no longer be able to pay its bills as of December 1.

Responsibility for New York City's financial problems has thus been abandoned on the front doorstep of the Federal Government like a poor, unwanted child.

As your President, I believe the time has come to make my position clear to the citizens of New York and to those across the land:

-- To sort out fact from fiction in this terribly complex situation;

-- To say what solution will work and what should be cast aside;

-- And to tell all Americans how the problems of New York City may relate to their lives.

This is what I would like to do tonight.

Many explanations have been offered about what led New York City into this quagmire.

Some have said it was the recession, the flight to the suburbs of the city's more affluent citizens, the migration to the city of poorer people, and the departure of industry.

Others have said that the city has become obsolescent, that decay and pollution have brought a deterioration in the quality of life, and that a downfall could not be prevented.

Let's face the facts: many other cities in America have faced these same challenges, and they are still financially healthy today. They have not been luckier than New York; they have simply been better managed. old saying - harder you try, the luckier you are -

No city can expect to remain solvent if it allows its expenses to increase by ___% every year, while its revenues are increasing by only ___% a year. Yet the politicians of New York City have done precisely that for the past ___ years.

Consider what this has meant in specific terms:

-- Over the last decade and a half, the number of residents in New York City has actually declined, but the number of people on the city's payroll has increased by 50 percent.

-- One-third of the employees now on the city's public education staff teach not a single student. They have either clerical or administrative jobs.

-- New York's municipal employees are generally the highest paid in the United States. A sanitation worker with three years experience now receives a base salary of $15,000 a year; fringe benefits and retirement add 50 percent a year to the base. At the same time, a New York City subway coin changer receives a higher salary than a private ~~bank clerk.~~ in N.Y. City?

-- In most cities, city employees are required to pay 50 percent of the cost of their pension. New York City is the only major city in the country that doesn't charge its employees a penny.

-- Retirement for municipal employees in New York often comes at an early age, and in many cases at incomes far above normal salaries.

-- The city has built a surplus of hospitals, so many in fact that 25% of the hospital beds are regularly empty.

-- The city also operates one of the largest universities in the world, and it's tuition-free for any high school graduate who wants to attend.

-- And for those on welfare, the city now pays out 10 times as much per capita for benefits and assistance as any other major city in the country.

?

I do not mean to chastise The people of New York for ~~its~~ the behavior or even for its generosity of spirit. That was ~~its~~ their decision, as it should have been. But when we look back over what the New York citizens ? power brokers have allowed to happen over the last 10 years:

-- A steady stream of unbalanced budgets;

-- A tripling of the city's debt;

5

public employees

-- Extraordinary increases in union contracts;

~~other~~ New Yorkers

-- And a defiance of the experts who said again and who

By name — citizens Budget commission

economists Business

again that the city was courting disaster,

then we should have no doubt where true responsibility lies. And when the city now asks the rest of the country to pay its bills, it should come as no surprise that many Americans ask why. Why should they pay for extras ~~luxuries~~ in New York that they have not been able to afford in their own communities? Why should the working people of this country be forced to rescue those who bankrolled the city's policies for so long -- the big banks and other creditors? So far, in my opinion, no one has given them a satisfactory answer.

What they have been told instead is that unless the rest of the country bails out New York, there will be a catastrophe for the United States and perhaps for the world. There is no objective evidence to support that conclusion.

It would be more accurate to say that no one really knows precisely what would happen in our financial markets if New York defaults. It's a matter of ~~judgment~~ prophecy. Our own analysis within the Government leads us to conclude that the financial markets have already made a substantial adjustment in anticipation of a possible default and that further disruptions would be temporary. The economic recovery would not be affected. I can understand why some might disagree with our conclusion and would speak out about their reservations. What I cannot understand -- and what none of us should condone -- is the blatant attempt in some quarters to frighten the ~~American~~ Congress
people into ~~submission~~ Capitulation [illegible] [illegible] action. This nation will not be stampeded; it will not panic when a few desperate politicians and [illegible] bankers try to hold a gun to its head. What we need now is a calm, rational decision about what the right solution is -- the solution that is best for New York and for all Americans.

To be effective, the solution must meet three basic objectives:

-- It must maintain essential services for the residents of New York City. They have become innocent ~~pawns~~ victims in this struggle. ~~I promise~~ those citizens that the Federal Government will not let them suffer terrible hardships in the months ahead.

-- Second, the solution must ensure that New York City will ~~have~~ achieve and maintain a balanced budget ~~as rapidly as possible.~~ ~~within 2-3 years~~ ~~all thereafter.~~

-- And third, it must ensure that neither New York City nor any other city ever becomes a ~~permanent ward~~ dependent of the Federal Government. I will not be a party to any arrangement which destroys our ~~delicate~~ Constitutional separation of powers between the Federal, state and local governments. There is already too much power in Washington.

There are at this moment eight different proposals under consideration in the Congress to prevent default. All are variations of basically one solution: that the Federal Government would guarantee the future bonds of the city so that it could borrow additional money in the financial markets. The sponsors say that the guarantee would be short-term because the city could be forced by Federal law to balance its books within three years.

I am fundamentally opposed to this solution, and I want to tell you why.

Basically, ~~I think~~ it is a mirage. Once a Federal guarantee is in place, there is no realistic way to expect that the budget will ever be balanced ~~within a short period of time.~~ The city's politicians have proved in the past that they are no match for the MASSIVE network of pressure groups facing them. An indication of what is likely to happen as soon as the pressure is off was provided by Mayor Beame last week when he vowed he will fight to restore the very jobs he has just been forced to cut. ~~In the same way, the New York Times reported indications last week that in exchange for help from the teachers union, the political leadership of the State made concessions which could threaten their own efforts to balance the budget.~~ So long as "politics as usual" continues in New York -- so long as the coalition of power brokers remains undisturbed -- there can be little serious hope that hard, tough decisions will be taken. A guarantee would change nothing in New York's power structure. Instead, it would inevitably lead to long-term Federal control over the affairs of the city.

Although [illegible] happened new york way going back to 1960

Such a step would not only violate the principles of Federalism but would set a very undesirable precedent for the Nation. To do so would encourage – ~~How can we deny other cities the same benefits extended to New York?~~ And what discipline would be left on the spending habits of other city and state governments once a Federal [illegible] - will of the

~~If there is a Federal default~~

~~the discipline of the marketplace is removed~~? This is not a precedent that any of us can welcome.

Finally, I think we ought to recognize who the prime beneficiaries of this guarantee program will be. Not the people of New York City: as I promised earlier, essential services will continue for them regardless of what happens. Not the people in other cities and states across the nation: a guarantee will not help them at all. No, those who will benefit the most are the New York politicians who made deals and the investors who have put their money in New York City securities -- the big banks and other investors, many of whom are wealthy.

a high who anticipated a high return

I am a strong believer in the financial marketplace, a system in which institutions and people with money can freely invest their funds. They willingly take risks, and the higher the risk, the more profits they get for their investment. But everyone knows that sometimes risks turn sour. And when the risks do turn out to be bad, as in New

York City, I do not believe that the Federal Government should then make them good. To me, it is clear that those who made the choice to invest their money should now bear the risk, not the 200,000,000 Americans who never made such a choice.

Does this mean there is no solution? Not at all. There is a sound and sensible way to resolve this issue, and I want to set it forth tonight.

First, I propose that the leaders of New York face up to reality. Either they must take firm steps to avoid default, or they should prepare to accept the inevitable. They argue that they have run out of resources to help the city. I disagree. What they have run out of are alternatives that are politically easy. They can still take the tough but decisive step of balancing r~~aising their taxes.~~ ~~[illegible]~~ revenue and spending. ~~into balan~~ And if they do, they can save themselves from default.

There is no reason why citizens in the rest of the country should raise the money when it can still be done by the citizens of New York.

7

Second, I propose that the Federal Government act now so that if the leaders of New York permit a default, it will be orderly and limited in impact. A chaotic struggle among the city's creditors and even among its employees would seriously complicate the city's problems. Unfortunately, present Federal law is inadequate to deal with ~~this~~ the problem.
[illegible]
Therefore, I will tomorrow submit to the Congress special legislation providing the Federal Courts with sufficient authority to carry out an orderly reorganization of the city's financial affairs.

Under this legislation, a Federal judge would be able to appoint a trustee of the court who could temporarily delay payments to the city's creditors and, of critical importance, could force the city to gradually balance its budget. The power to bring necessary reforms in the city's budget-making process is essential; by placing it in the hands of a trustee, who will be supervised by the court, we will not only ensure that it is properly exercised but that it is also temporary in nature.

Let us recognize, however, that even by postponing payments to creditors and by curtailing some of its expenses, the city will still lack sufficient funds to pay its bills for as much as three years. Therefore, I am proposing that the court trustee be allowed to issue certificates to cover these shortages. These certificates would be like short-term loans and would be issued to the public. They would be guaranteed not by the Federal Government but by special revenues collected by the State of New York. Specifically, I am recommending that the State of New York introduce a temporary tax which creates enough cash to stand behind the trustee certificates. The tax would be temporary, and the money collected might even be held in escrow so that it could be returned to taxpayers after the city's financial affairs are put in order. State officials argue that the taxes in both the City and the State are already too high; further taxes would only darken their economic hopes for the future. That is true. But because it is true, then the tax should serve another very good purpose: it will give New York's leaders a strong incentive to clean up their financial affairs quickly so that the tax can be removed.

To summarize, the plan I am recommending tonight is this: if New York fails to act in its own behalf, there should be an orderly default supervised by a Federal Court and financed by a temporary New York tax. This plan will work. It will work because it is sound. It will work because it is fair.

The only ones who will be hurt by this plan will be those who are fighting so hard to protect their power and their profits: the city's politicians and the city's creditors. And the creditors will not be hurt much because eventually their investments will be rewarded. For the people of New York, this plan will mean that essential services will continue. There may be some temporary inconveniences, but that will be true of any solution that is adopted. Moreover, New Yorkers have shown over the years that when it comes to coping with temporary inconveniences, they are better at it than anyone else in the world. For the financial community, the default may bring some temporary disorder but the repercussions will not be massive. In fact, there is solid reason to believe that once the uncertainty of New York is ended, investors will begin returning to the markets and those markets will be sturdier. Finally, for the people of the United States, this plan means that they will not be asked to assume a burden that is not of their own making and should not become their responsibility. This is a fair and honorable way to proceed.

In conclusion, let us pause for a moment to consider what the New York City experience means for the United States.

Two weeks ago, I spoke to you about the choice I believe we face as a nation: the choice between continuing down a path of higher government spending, higher government deficits, and more inflation or taking a new direction by cutting our taxes and cutting the growth in government spending. Down one fork, I said, lies the wreckage of many great nations of the past. Down the other lies the opportunity for greater prosperity and greater freedom.

Tonight I think it is clear what path New York City chose. None of us can take any pleasure from this moment, because the leaders of New York were in a very basic sense following the same practices they saw in Washington. The difference is that Washington owns printing presses and can always print more money to pay its bills. But ultimately the practice of living beyond your means catches up with a nation just as it catches up with a family or city. And for the citizens of that nation, the bill comes due either in the form of higher taxes or the harshest and most regressive tax of all, inflation.

All of us tonight care especially about the people of New York City: they have worked hard over the years to create one of the greatest centers of civilization. But as we work with them now to overcome their difficulties, let us never forget what led that city to the brink. And let us resolve that these United States will never reach the same crisis.

Thank you and good evening.