THE WHITE HOUSE

WASHINGTON

August 8, 1975

MEMORANDUM FOR THE PRESIDENT

FROM: L. WILLIAM SEIDMAN LWS

SUBJECT: New York City Financial Situation

Attached for your information is a memorandum from Acting Secretary Gardner on the New York City financial situation. It may be useful to have a brief discussion with you about the consequences of a default by New York City which have been purposely left out of the attached memorandum.

We will be prepared for a short meeting with you after tomorrow's 8:15 Economic Policy Board meeting if you desire. I recommend that the meeting include Dick Dunham, Stephen Gardner, and Arthur Burns.

Attachment

THE SECRETARY OF THE TREASURY
WASHINGTON 20220

August 8, 1975

MEMORANDUM FOR THE PRESIDENT

SUBJECT: New York City Financial Situation

As part of our continuing process of monitoring New York City's financial situation, George Mitchell of the Federal Reserve, Bill Seidman, Dick Dunham and I met with representatives of the Board of Directors of the Municipal Assistance Corporation (MAC). The Board outlined the steps which the City has undertaken, which include: 1) a freeze on wages; 2) an increase in the subway fare to 50¢; 3) a freeze on controllable expenses, and 4) the imposition of an independent management structure.

Due to these and other efforts, MAC has been able to raise the necessary August financing requirement of approximately $1 billion. However, they are most fearful that they will not be able to meet the large September requirement and that there may be a default.

The State Budget Director reported that the net 1976-77 budget imbalance of projected revenues over projected expenditures was $600-800 million.* This projected imbalance does not include $500 million of operating expenses included in the capital budget of $1.5 billion. Thus, from an accounting standpoint (not from a legal standpoint) the imbalance is about $1.2 billion. If funds cannot be borrowed to finance the capital budget items of $1.5 billion later this year the total cash imbalance will be around $2 billion.

Therefore, the City or Big MAC must borrow about $2 billion to cover the current imbalance (the capital budget items and the short term cash flow needs). The total borrowing by one or the other to cover all these needs during the period September until about March of

---

*Within a $200 million accuracy.

1976 is in the neighborhood of $4-5 billion. Assuming the City can't borrow on its own, MAC will have to seek an enlargement of its authority from $3 billion to $6 billion to attempt to handle another large portion of the City's cash need.

Given their fear of an inability to raise the necessary funds in September, they again raised the question of a federal guarantee or insurance program. We offered no encouragement at all for such a request. We continue to feel that any form of federal guarantee or insurance is objectionable substantively. Among other things, it would be impossible to contain and in effect could result in the federalization of all municipal financing. Even if we sought to move in this direction, it would require legislation which it would be virtually impossible to enact in time for their September requirements and may not be achievable at all.

The Board asked if we would be willing to state that we were considering proposing legislation. We believe that such an indication would be misleading and thus potentially even more damaging. We feel strongly that we should continue to offer no encouragement for federal financial assistance.

We are now in the process of reviewing alternatives short of federal assistance. These will include the possibilities of: 1) further New York State action, and 2) the mobilization of private sector support through federal governmental urging.

If the City in fact goes through with the program outlined, it will have met the substantive objections which caused the closing of the market in April. The problem then becomes one of convincing the investing pbulic that the reforms have taken hold. Nevertheless, given the fact that a default may, in fact, occur we are also assessing that contingency.

I am attaching a copy of the statement we issued after the meeting. It is supportive of New York State, New York City and MAC in their efforts to move things in the right direction. We will keep in close touch with the officials on this situation and keep you advised.

Stephen Gardner

Stephen S. Gardner
Acting Secretary

Attachment

FOR IMMEDIATE RELEASE August 8, 1975

MEMORANDUM FOR CORRESPONDENTS

As part of a continuing process of monitoring New York City's financial situation, a meeting was held today at the Treasury Department.

Representatives of the Board of Directors of the Municipal Assistance Corporation (MAC) met with Acting Treasury Secretary Stephen S. Gardner, Federal Reserve Board Vice Chairman George W. Mitchell, Assistant to the President for Economic Affairs L. William Seidman, Deputy Director of the Domestic Council Richard L. Dunham, Under Treasury Secretary (Monetary Affairs) Edwin H. Yeo, III, and Assistant Treasury Secretary Gerald L. Parsky.

The New York group consisted of Thomas Flynn, Chairman, MAC Audit and Control Committee; Felix Rohatyn, Chairman, MAC Financial Committee; Herb Elish, Executive Director, MAC; and Peter Goldmark, New York State Budget Director.

The Government officials expressed their support for the efforts of the officials of New York State, New York City and MAC. The Government officials felt that the steps being undertaken by the City are sound. The progress shown to date clearly is in the direction which is necessary to place New York City on a sound financial basis. A further step in this process is the finalization of MAC's second financing plan, which was outlined by the New York group.

o 0 o

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE W04-2041

For IMMEDIATE RELEASE July 25, 1975

MEMORANDUM FOR CORRESPONDENTS

New York City's financial problems were reviewed today at a meeting at the Treasury Department.

At the invitation of Treasury Secretary William E. Simon, representatives of the Board of Directors of the Municipal Assistance Corporation (MAC) met with him, Federal Reserve Board Chairman Arthur Burns, Assistant to the President for Economic Affairs L. William Seidman, and Assistant Treasury Secretary Gerald L. Parsky.

The New York group consisted of William Ellinghaus, Chairman of the Board of MAC; Thomas Flynn, Chairman, MAC Audit and Control Committee; Felix Rohatyn, Chairman, MAC Financial Committee; and Peter Goldmark, New York State Budget Director. They provided the Government officials with a situation report on New York City's financial problems.

The Government officials expressed their appreciation for the information they received relating to the efforts to work out the long-term solutions to the problems of New York City.

Mr. Simon ended the meeting with the following statement:

"The MAC Board is performing a most critical public function and I am most supportive of the tentative program outlined to me. It is my hope that such a program will be implemented, for it is only through tough measures that New York City will be able to restore its financial credibility."

o0o

WS-368

THE WHITE HOUSE

WASHINGTON

July 25, 1975

MEMORANDUM FOR THE PRESIDENT

FROM: L. William Seidman LWS

Secretary Simon asked me to forward to you the attached memorandum on the New York City financial situation. We will have an up-to-date report for you on the effect of the New York City situation on other cities when you return.

Attachment

July 25, 1975

MEMORANDUM FOR THE PRESIDENT

Subject: New York City Financial Situation

Pursuant to your request, Arthur Burns and I have been monitoring New York City's financial situation. Today he, Bill Seidman, and I met with representatives of the Board of Directors of the Municipal Assistance Corporation (MAC) to get an update on their efforts to develop a long-term solution to the problems of New York City.

The Board outlined to us a program which they will be discussing with Mayor Beame, the labor unions, and the banking institutions. It involves a number of stringent measures, in addition to the personnel layoffs which Mayor Beame has apparently imposed (the Mayor has used a figure of 28,000 lay-offs. This number must be audited, however.) The program outlined includes:

1. Wage rollbacks to June 30th and freeze on all wages;

2. Increase the New York City transit fare from 35¢ to 45¢;

3. Reduce budget expenditures for the City University (the City would decide whether to accomplish this by imposing tuition charges or by reducing expenses through teacher layoffs, etc.);

4. Have the State take over the Court and Corrections System of New York City;

5. Impose a 3-year freeze on all expenditures for the City.

They also outlined what they will be asking of the commercial banks. Briefly, it involves increasing MAC credit by $250 million and converting August and September maturities into a $1 billion term loan at the prime rate.

They asked that the Federal Government consider playing a part by increasing the Comprehensive Employment and Training Act allotment to New York City. We have looked into this already, and for Fiscal Year 1976, New York City has been allocated about $165 million. Of that total, about $33 million was a discretionary allocation, which is one of the largest in the country. All the discretionary funds have been committed for Fiscal Year 1976, and so it would appear very unlikely that such help could occur. I will discuss this, however, with John Dunlop.

I am encouraged by what MAC is trying to do. If all of the steps outlined are taken, the City will be moving in the right direction. I am not convinced, however, that these actions will restore public confidence quickly enough to allow MAC to sell its bonds immediately. I believe something more must be done to convince the public that the reforms at the City level will be real and permanent. One possibility might be to place decision-making authority in the hands of MAC's Board and not the Mayor. That's a pretty drastic step and would require State legislative action, but I wouldn't rule it out.

The Board did not come to us asking for federal assistance. However, they did touch on the idea of either federal insurance or help from the Federal Reserve. Neither Arthur Burns nor I gave them any encouragement at all. We did not say that under no circumstances would we consider action. I told them that it would be your decision, but that until we saw a viable, concrete program of self-help, it would be counterproductive to discuss federal financial aid. In any event, I noted that we would need legislation and the chances for that were practically non-existent.

They agreed to characterize our meeting publicly by saying that we were given a report on a proposed program, but that no program had yet been implemented. Further, they would state that any talk of federal assistance at this point was premature.

I am attaching a copy of the statement we issued after the meeting. It is supportive of MAC's efforts (as it should be), but makes clear that the real answer to the City's problems is in its taking steps to help itself.

I will be staying in close touch with this situation, and will keep you advised.

William E. Simon

Attachment

THE WHITE HOUSE
WASHINGTON

August 1, 1975

MEMO TO: Bill Seidman

FROM: Jim Cannon

Bill:

If you have any comments, additions or changes, please let me know before the pouch closes at 3 p.m.

Attachment

Jim,
This looks good to me.

LWS

THE WHITE HOUSE

WASHINGTON

August 1, 1975

MEMORANDUM FOR THE PRESIDENT

FROM: JIM CANNON

SUBJECT: New York City Financial Situation

Here is a status report by Dick Dunham on the financial situation of New York City as it stands today.

This was prepared by Dick in consultation with Treasury officials and Bill Seidman.

Attachment

CC: The Vice President
Secretary Simon
Mr. Seidman

THE WHITE HOUSE

WASHINGTON

August 1, 1975

MEMORANDUM TO: JIM CANNON

FROM: DICK DUNHAM

SUBJECT: New York City Financial Crisis

The purpose of this memorandum is to bring you up to date on the New York City financial crisis.

The central question was and is will New York City go into default, either in August, through the failure of Big MAC to market additional securities for the City, or later in the fall when New York City must market its own securities.

The first test will be on August 4 when the underwriting group headed by Chase Manhattan tries to organize for a sale on August 7. The success or failure of next week's sale is, therefore, the first hurdle.

Since this sale and any subsequent issues of New York City or Big MAC depend primarily on investor perception, as much as the actual accounting facts, the acid test is the credibility of the Mayor's actions to correct the enormous imbalances and accumulated deficits of the City's finances.

City Actions

The Mayor has taken, or is taking, a series of steps which, if actually put into effect, will have both a substantive fiscal effect of restoring balance and also a dramatic effect which will help to restore investor confidence.

The steps announced include a wage freeze, cuts in the City University budget, capital budget cuts, abolition of a few agencies, a $.15 subway and bus increase, and bridge toll increases. The value of these proposals to the current City budget is around $500 million. Whether or not this amount is sufficient to balance the current City budget and/or to restore investor confidence in New York City finances is, of course, unknown.

Two points in regard to these proposals must be kept in mind. First, they must be enacted and implemented by the Mayor and, secondly, the union rank and file and the general public must accept them before their impact can be completely evaluated.

That is, if the Mayor backs down or the City Council fails to enact the wage freeze or if there is a substantial disruption in city services by union member action, investor confidence will not be restored.

August Big MAC Sale

The underwriting group handling the August 7 sale of $1 billion in Big MAC bonds has of this time, Friday p.m., put together a tentative package which will provide the funds needed to cover the August cash flow needs of the City and to prevent default of the large note issue coming due on August 22.

The package includes $250 million by the banks, a $100 million rollover of August notes held by the banks, $120 million State welfare advance, $270 million in State pension fund investments and a $250 million public offering, of which insurance companies and other institutions will take a major part.

This package, however, cannot be characterized as a "successful underwriting" since only half of the issue is new public investment. The balance is an advance, a rollover and a State-controlled investment.

It can, therefore, be characterized as only a postponement, which is desirable, but neither a permanent solution nor an indication of investor confidence. If successful, it will prevent an August default and allow more time to evaluate the City's actions.

Broader Effects of Municipals

Treasury is monitoring and attempting to evaluate the spillover effect of the New York City situation on other municipals. At this time we do not see any other major city experiencing similar difficulties.

Other New York State agencies, including the Housing Finance Agency, may be experiencing difficulty and liquidity problems this month. In large part this is due to the publicity of the New York City situation and also because there is market recognition that a large portion of their cash inflows is from New York City and City projects.

Conclusion

The situation is still serious and tenuous, but there is cause for some optimism because of both the City's actions and the fact that there will likely be a sale of the second Big MAC issue, thus avoiding an August default.

THE WHITE HOUSE

WASHINGTON

August 28, 1975

MEMORANDUM FOR THE PRESIDENT

FROM L. William Seidman LWS

SUBJECT New York City

John McCloy called to relay Governor Carey's message with respect to the current situation. Governor Carey knows that the Federal Government cannot provide assistance. He does believe that they could be helpful by taking "a less cavalier" attitude. Governor Carey will be meeting with Chairman Burns to discuss this further tomorrow.

McCloy has just returned from Europe where he reports that European bankers and government officials are very concerned about the possible effects upon them of such a default. McCloy also reports that Paul Volcker, President of the New York Fed, points out that a default while the IMF is meeting in Washington would be particularly unfortunate.

I told him I would relay the message to you.

ASSISTANT SECRETARY OF THE TREASURY
WASHINGTON, D.C. 20220

July 24, 1975

NOTE FOR BILL SEIDMAN
ASSISTANT TO THE PRESIDENT
FOR ECONOMIC AFFAIRS

FROM: Gerald L. Parsky GLP

Attached is an updated summary of the New York City situation prior to our being briefed tomorrow.

Attachment

Update on New York City Financial Situation

On Thursday, July 17, the underwriters informed the MAC Board that a second $1 billion issue would not be marketable unless "drastic" fiscal measures were imposed. The underwriters also emphasized that any such action would not be credible (and therefore not effective) unless the City, the State and MAC fully participate in the announcement and implementation of such measures.

1. Cash Flow Situation. Without new money, the City's cash flow turns negative on approximately August 4. By juggling accounts, it can probably operate beyond that date, but will default on August 14, when a major payroll comes due. On August 22, $792 million in notes are due.

2. Budget Situation. In view of the market situation (see below), it now appears that a budget reduction far larger than those previously discussed -- i.e., more than $500 million -- will be required to break the impasse. The following specific budgetary actions are being discussed:

-- wage freeze

-- pay cut for higher salaried employees

-- lay-offs

-- tuition charges at City University

Late last week, the Mayor -- for the first time -- conceded that measures other than lay-offs were probably necessary.

The unions remain adamant. They contend that they are being asked to go "cold turkey" -- to remedy in one year a problem which has built up over 15 years -- while everyone else proceeds on a business as usual basis. They point specifically to the banks -- which continue to accrue high rates of tax-exempt interest -- and to the welfare recipients -- whose payments will remain at the same high level.

MAC views its current role as attempting to mediate between the City and the unions. It is reluctant to take it upon itself to develop and announce a compromise proposal because it believes that would be the final step in emasculating the City administration.

The alternative to a compromise is a solution imposed on the employees by the City and/or the State. Apart from lay-offs, any such measures (i.e., a wage freeze) would involve the breach of existing labor contracts. Especially in view of a recent court decision, it is doubtful that the Mayor has the authority to take such steps unilaterally. We understand that Governor Carey, as a last resort, is willing to call a special session of the State Legislature to grant the City such authority.*/

The Role of the Banks

It appears clear that no voluntary agreement will be reached without some form of concession by the New York banks. The apparent options are:

1. Roll over short term debt holdings at a reduced interest rate.

2. Agree to a moratorium on long term debt amortization payments.

3. Provide large, low interest rate, loan.

Since the third option requires a substantial commitment of new money, it is obviously the least desirable from the banks standpoint. With respect to the first two options, there is doubt -- especially at MAC -- that the amounts involved will be "enough" to satisfy the other participants in any compromise.

---

*/The Treasury General Counsel's office believes that unilateral action would violate the Federal constitutional prohibition against state impairment of contracts. However, MAC's lawyers believe that there would be authority under the state's general police powers.

The banks are also reluctant to increase substantially their already large holdings of MAC debt. They fear that the more they hold, the easier it will be for the State Legislature to refuse to make the annual appropriation required to meet MAC's debt service obligations.

Condition of the Market

All parties appear to agree that there will be no market for MAC debt in August without the "drastic" measures. When the first MAC syndicate was broken on July 21, the two long maturities (1985 and 1990) each fell 10 points. Although a small portion of the drop can be attributed to unrelated factors (e.g., Federal Reserve bill sales), the price drop primarily reflects lack of investor confidence in any security associated with New York City. This lack of confidence was tangibly enhanced by the weekend statements of union leaders indicating they would hold out, even if it meant default. Our sources indicate that most market participants cited this apparent tolerance of the possibility of default as a primary reason for selling or for cancelling purchases.

The Outlook

All of our contacts are extremely pessimistic. There is considerable doubt that the City administration is capable of providing the leadership required to achieve a compromise and to restore confidence. With respect to the unions, there is doubt that (i) individual leaders will make the necessary concessions, (ii) that the leaders can agree among themselves as to the concessions, and (iii) that the leaders, even if they do agree, can deliver the rank and file.

There appears to be little prospect of further state financial assistance. First, the state has virtually no funds available, and certainly not enough even to make a dent in the City's problem. Second, the state will argue that it fulfilled its obligations through the creation of MAC and that it is up to the other parties to act.

The Federal Role

In light of the above, all parties are again beginning to look in our direction. Our options have not changed much since May. They include:

1. Guarantee or purchase of City securities (requires legislation)

2. Guarantee or purchase of MAC securities (requires legislation)

3. Federal Reserve purchase of City securities

4. Federal Reserve purchase of MAC securities

5. Advance Revenue Sharing and Medicaid

6. Assistance under Disaster Relief Act

The new options involve providing money to MAC rather than the City and the Disaster Relief Act approach. It would not appear that Congress' probable reaction would be influenced by MAC's participation. However, in view of the fact that MAC's borrowing is secured by a legislative grant of tax revenues, the Fed might be more comfortable with a loan to MAC, as opposed to the City.

The utility of the Disaster Relief Act is less clear. Certainly, if civil strife or widespread loss of services occurred, the Act (as well as other provisions of law) would authorize the USG to provide assistance. However, the Act does not specifically authorize the provision of cash, which would be necessary to meet payrolls and debt service obligations.

Of course, identifying the options does not answer the threshold question whether the Federal Government should act to prevent a default. On the one hand, many of the same concerns which existed in May -- e.g., expense and impact on Federal budget and borrowing, breach of faith with respect to other local governments which have taken stringent measures, etc., -- are still present. However, since the City has already withstood so much pressure for reform, this time we cannot conclude with the same degree of confidence that a default would serve as a catalyst for immediate and effective action at the local level. Accordingly, the adverse effects of default -- long term impairment of the City's credit, risks of serious consequences in the securities markets -- take on somewhat more significance.

MEMORANDUM FOR THE ECONOMIC POLICY BOARD

FROM: William E. Simon
Secretary of the Treasury

James M. Cannon
Director, Domestic Council

SUBJECT: New York City Financial Problem

Purpose

The purpose of this memorandum is to bring you up to date on the New York City fiscal problem and the changes that have occurred since the President met with Governor Carey and Mayor Beame on May 13, 1975.

Because it is very likely that the Federal government will be forced to become involved once again in the problem and asked to participate in the solution, we propose that a joint Domestic Council-Economic Policy Board Review Group be established to monitor the situation and to deal with urban problems in general. We also propose that the EPB immediately establish a liaison with the N. Y. Municipal Assistance Corporation.

Background

The fiscal problems which now beset New York City result at least in part from circumstances which are common to most major cities throughout the nation and in part from conditions which are peculiar to New York. It is true, of course, that the fiscal and/or management mess in New York City is considerably more pronounced there than in many other major cities, but it is also true that many of the symptoms lie just below the surface in other major cities. Boston, for example, has considerably increased its borrowing in the last few years also to cover deficits.

If, therefore, a Federal role in the solution to the New York City problem becomes necessary, the pattern of such a role will create a precedent for Federal relationships with other cities, and it will be extremely difficult, if not impossible, to confine any such role uniquely to New York City.

New York City-New York State Action

Since the May 13 meeting, both the City and the State have taken some action toward resolving the crisis.

(1) The State established the Municipal Assistance Corporation to sell $3 billion of long term debt which will replace an equivalent amount of New York City short term debt and thus solve the immediate (until September 30) cash flow problem.

The Corporation, in addition, has some oversight powers in regard to the management of the City budget.

(2) The State has provided $330 million of new taxing authority to help alleviate the FY 1975-76 City operating budget problem.

(3) The adopted City budget does provide for some cutbacks of personnel and some reduced services.

In May the problem was three-fold:

(a) An inability to borrow in the public market resulting in inadequate cash to meet payrolls, other operating expenses and debt service.

(b) The failure to present a budget for FY 1975-76 that was balanced and perceived to be credible.

(c) A long term imbalance between revenues and expenses due in large part to fiscal mismanagement, but also due to structural weaknesses in the City's economy, such as shift in the mix of population from middle class to underprivileged, unionization, extensive city services, etc.

Even though some tentative steps have been taken by the City and State, basic financial problems still face the City. They have been only slightly postponed.

These financial problems can be broken down chronologically:

-- First, there is the question whether the Municipal Assistance Corporation (Big MAC) will be able to raise the additional $2 billion required to meet the City's cash flow requirements through September 30.

-- Second, the City itself must borrow from $4 to $5 billion in the short term market between October 1 and the end of the fiscal year.

-- Finally, there is the broader question of market access for both short term needs and capital improvements for future years.

I. MAC's Market Access

Two factors lead to concern about MAC's ability to raise $2 billion in August and September. There continues to be resistance to any security -- and particularly a security not bearing the full faith and credit pledge -- carrying the words New York. This resistance was reflected in the rather lukewarm response to MAC's first $1 billion offering; it will be compounded with respect to later issues by the sizeable quantities of MAC's debt already in the market.

Moreover, the fact that the state legislature must annually appropriate funds to meet MAC's debt service obligations is another source of concern. Unlike the typical "moral obligation" bond which requires a legislative appropriation only in the event the primary revenue source backing the debt is inadequate, MAC's enabling legislation requires annual legislative action merely to provide MAC with access to the money in the debt service fund specifically earmarked for debt service. Investors are naturally concerned that future political considerations -- even ones totally unrelated to MAC's activities -- may block or delay payments on MAC's debt.

Despite these very real problems, the consensus is that MAC will be able to market the additional $2 billion in August and September. It is likely, however, that the borrowing cost for these issues will be even higher than 9+% net interest cost of the first issue. Since MAC's debt service expenses directly reduce the City's revenues, these high borrowing costs are a basis for concern.

II. The City's Market Access

Even after MAC's $3 billion "contribution" is subtracted, the City's total short-term financing needs during the period October 1, 1975 - March 1976 will amount to approximately $4-5 billion. These amounts are required primarily to refund outstanding short-term debt and to finance the $1.6 billion capital budget (including some $700 million in operating expenses). Such capital financing must be done in the short-term market since, even under the most optimistic assumptions, there is no likelihood of the City having access to the long term market this year.

The ability of the City to raise these funds in the public market depends almost entirely on Mayor Beame's actions over the next 45-60 days. If his conduct is responsive to the market's judgment that

-- the payroll is too large;
-- wage and benefit levels are too high; and
-- the range of services is too broad --

then a market should exist in October. If not, another source of outside funds must be found or the City will default not later than late November or early December.

To quantify the budget picture, prior to late June, the City could identify approximately $11.95 billion in FY 75 - 76 revenues. Limiting expenditures to that level through lay-offs alone would have required a reduction in the City work force of approximately 50,000 employees.

Immediately prior to June 30, state legislative leaders granted the City $150 million in taxing authority. Again, looking only at the lay-off potential, this increase reduced the required lay-offs to 30,000.

Finally, on July 3, the legislative leaders agreed to increase the new taxing authority to $330 million. When taken with a possible $55-60 million increase in state aid to education, and additional state and Federal matching funds occasioned by the revenue increases, the "final" revenue level could be in the range of $12.35-12.40 billion.

Along with the general "flexibility" that exists in the budget, */ this revenue level would permit the Mayor to rescind all lay-offs in the uniformed services (police, fire, sanitation), leaving only some 4-8 thousand layoffs in the clerical, education and health areas. And Victor Gotbaum, president of the largest non-uniformed municipal union, has proposed, in return for rescission of all lay-offs in his area, that his members take their 1975-76 contracted wage increases in the form of new City short-term debt. Mayor Beame has tentatively rejected this proposal.

This analysis has focused on lay-offs largely because the City has not suggested any alternative approach to expenditure cuts -- e.g., wage freeze, tuition charges at the City University, etc. And it is becoming more clear that the Mayor, if left to his own devices, will avoid any meaningful reductions in expenditures through lay-offs or other means.

Simply stated, inattention to the expenditure side in the next few months -- irrespective of whether a "balanced" budget is presented -- will result in the continued unavailability of the public market in October and beyond. The market has made the same judgment we have -- namely that the City spends too much. Until the City cuts its spending level significantly, there is little likelihood of market access.

A fair question, however, is if the City in fact balances its budget, is the market's judgment too harsh? The fact is that the City's budget for FY 75-76 and later years is far from balanced in any meaningful sense. In evaluating the City's budget, the following factors, among others, must be considered:

-- the City is continuously refunding a cumulative short-term borrowing load (created by past deficits) of at least \$2 billion.

-- some \$700 million of operating expenses are in the capital budget (the MAC legislation requires that this practice be phased out over ten years).

*/ e.g. Approximately \$200 million of the amount budgeted for debt is allocated to interest on notes maturing prior to September 30 and on notes which would have been issued by the now defunct Stabilization Reserve Corp. Assuming that MAC pays the interest on the maturing notes, all of these funds will be available for other purposes.

-- the City includes as budget revenues all employee pension fund earnings in excess of 4%, more than $100 million in FY 75-76, yet the pension funds are seriously under-funded.

-- the City includes as budget revenues all real estate tax liabilities, yet the delinquency rate grew to 7% in FY 74-75 -- the total delinquent amount may be as high as $500 million.

-- historically, the City's budget revenue estimate has substantial overestimated state and federal aid payments as reflected in the large, but incorrect, "receivables" shown in the City's annual statements.

-- historically, the City's budgets have shown estimated revenues on an accrual basis and expenditures on a cash basis; this practice has the general effect of overstating revenues and understating expenditures.

-- in FY 76-77 and beyond the City's sales tax revenues will be reduced by substantial amortization requirements on Big MAC debt.

Clearly, nothing the Mayor does in the next two months will alleviate all of these conditions. But the market is not asking for overnight miracles. What could reopen the market is an expenditure level of $12.1 - 12.2 billion and the application of the remaining "new money" (some $300-350 million depending upon the size of the cuts and the precise amount of the net interest savings referred to in the footnote above) to certain highly visible corrective steps. For example, the City could establish a reserve against tax delinquencies, leave all or a portion of the "excess" pension earnings in the funds, re-establish its "rainy-day fund" (a general reserve against contingencies), or remove a portion of the expense items from the capital budget.

Frankly, as implied by the above discussion, there is little indication that the City government, left to its own devices, is prepared to take such steps. It would appear that only the state -- through MAC -- is in a position to place any effective pressure on the City. MAC's ability to provide meaningful direction for the City is in turn dependent upon its awareness of the problems and its willingness to incur the political risks involved. At present, MAC has no staff and the Board itself is fully occupied with the problem of raising its own funds. Accordingly, at least on the basis of MAC's actions to date, there can be little optimism that MAC will provide the needed guidance.

Demands for a Federal Role

The key to restored access to the public market is the steps the City itself takes to restore market confidence. However, if the City is unable to sell its securities in the fall, we will again be confronted with demands for some form of Federal financial assistance to avoid a default. Moreover, at that time, a default would appear even more undesirable than it did in the spring. A default at any time would have long term adverse effects on the City's credit. However, in the spring it was at least possible that a default could have served as a catalyst for effective remedial action at the state or local level. The intervening months have served to lessen the catalytic potential of a default in at least two respects.

First, the City's failure to act over the intervening months will detract from the credibility of any action it might take on its own. Second, the formation of MAC has virtually exhausted the options available at the state level. In short, the market is likely to conclude that since the City and MAC were unable to take the necessary steps during the six month "grace" period they received, there is little reason to derive confidence from whatever hasty actions they may take following a default.

In addition, any demand for Federal involvement will probably be accompanied by a showing that some of the problems that New York City faces can legitimately be placed at the Federal doorstep. Mayor Beame has already begun to use argumentation to that effect. If a major crisis occurs, such argumentation will be accelerated. For example, the City can legitimately argue that the problems of illegal aliens and policing the United Nations are Federal responsibilities.

Recommendations

1. It is recommended that a joint Economic Policy Board-Domestic Council Review Group be established to monitor and study the problem of cities or major urban areas.

By generalizing the study to include all major urban areas, we can continue to monitor closely the New York City situation, yet avoid the political problems inherent in any direct attempt to pressure the City toward fiscal reform.

The agenda of such a Review Group could include:

-- Review of Federal fiscal initiatives that may be proposed such as:

(a) Federal Insurance for Municipal debt.

(b) Federal Guarantees of Municipal debt.

(c) Federal purchase of Municipal debt.

-- Review of existing Federal powers in the event of a major default in New York or any other city:

(a) Federal Reserve action.

(b) Use of the Disaster Relief Act of 1974.

-- Review of existing and potential Federal programs which may impact on the City's finances:

(a) Illegal alien problem.

(b) Cost of United Nations police.

(c) Public Assistance and Medicaid Administration.

(d) Improvement or speed up of Federal cash flows.

(e) Narcotics control.

(f) Scholarships and/or tuition assistance.

(g) Review of other Federally mandated standards and programs.

-- Review and consideration of direct or indirect Federal involvement in financial management improvements:

(a) Mediating or reviewing labor relations.

(b) Accounting improvements and reform.

(c) General management improvement assistance.

2. At the same time, recognizing the limited amount of time available before another crisis develops in New York City, it is recommended that the EPB establish a liaison with MAC with the objective of action by MAC to force the City to take reform measures.

As indicated above, any direct Federal moves in this direction would be counterproductive. Nothing would play more into the hands of the unions and the City Administration, which could claim -- to a highly responsive audience -- that the Ford Administration was threatening and bullying the City into actions designed to harm the low and middle classes.

However, MAC, if it moves quickly enough, does have the power to force changes. While its statutory authority is quite weak, between now and September its ability to withhold cash provides it with substantial leverage. As indicated above, however, to date MAC has not moved in this direction and there is no indication that it has plans to do so. The EPB should consider establishing contact -- probably on a private basis -- with selected MAC Board members and attempt to impress them with the urgency of the situation and the importance of MAC acting while it still has the financial leverage.

Office Memorandum • UNITED STATES GOVERNMENT

THE COMPTROLLER OF THE CURRENCY

TO : Mr. Robert A. Mullin
Deputy Comptroller of the Currency

DATE: 7/30/75

Secret

FROM : Mr. Thomas E. Zemke TZ
National Bank Examiner

SUBJECT: New York City Obligations held by National Banks.

The following data covering banks holding New York City Bonds has been encapsulated by the Victor staff per your request:

1,746 banks hold NYC obligations totaling 1,753,525M.

48 banks have holdings in excess of 50% of gross capital funds (see attached list).

It was noted that numerous banks have holdings of between 10 to 20% of capital. A detailed list of these banks could be made available if desired. The two largest holders of bonds are Chase Manhattan Bank, 263MM and Bank of America, 113MM. Their proportionate investment to capital is 14% and 6%, respectively.

TEZ:ryc

TOTAL N.Y.C. OBLIGATIONS OUTSTANDING PER REGION AND NUMBER OF BANKS HOLDING SAME

REGION	OBLIGATIONS	NO. OF BANKS
1	42,962	74
2	587,706	172
3	215,123	130
4	41,580	114
5	143,637	117
6	137,895	138
7	90,234	206
8	75,083	162
9	34,692	197
10	71,019	151
11	57,757	183
12	46,475	44
13	20,128	41
14	189,234	17
	1,753,525	1,746

HOLDINGS OF N.Y.C. OBLIGATIONS
IN EXCESS OF 50% OF CAPITAL

(000's) omitted

Name of Bank	Gross Capital Funds	Par Value NYC Bonds	Bonds As Percent Of Capital
Region 1			
Citizens National Bank Southington, Connecticut	1,149	650	56%
Harbor National Bank Boston, Massachusetts	2,624	4,060	154%
Columbus National Bank of Rhode Island Providence, Rhode Island	5,796	11,300	194%
Region 2			
Republic National Bank of N.Y. Brooklyn, New York City	93,156	50,760	54%
First National Bank of Dryden Dryden, New York	1,560	1,195	77%
Deak National Bank Fleischmanns, New York	963	1,060	110%
Citibank Suffolk N.A. Islip Twp Bay Shore	2,874	4,230	147%
Century National Bank & Trust Co. New York, New York	6,465	8,075	125%
Flushing National Bank Flushing, New York	2,209	5,630	255%
Sterling National Bank & Trust Co. New York, New York	41,259	51,215	124%
First National Bank of Norfolk Norfolk, New York	601	338	56%

Name of Bank (Region 2 cont'd)	Gross Capital Funds	Par Value NYC Bonds	Bonds As Percent Of Capital
National Bank of Roxbury Roxbury, New York	437	700	160%
National Bank of Stamford Stamford, New York	1,487	805	54%
Tupper Lake National Bank Tupper Lake, New York	1,642	910	55%
Citibank Mid Hudson, N.A. Woodbury Twp., New York	2,646	1,915	72%
Hudson Valley National Bank Yonker, New York	2,659	1,500	56%
Region 3			
None			
Region 4			
None			
Region 5			
Industrial Bank of Washington Washington, D.C.	2,651	1,500	56%
First National Bank of St. Marys Leonardtown, Md.	2,915	5,300	181%
Dominion National Bank of Penins York County, Virginia	1,278	2,000	156%
Citizens National Bank of St. Albans St. Albans, West Virginia	1,241	675	54%
First National Bank of St. Marys St. Marys, West Virginia	729	520	71%
First National Bank of South Charleston South Charleston, West Virginia	2,782	4,015	144%

Name of Bank (Region 5 cont'd)	Gross Capital Funds	Par Value NYC Bonds	Bonds As Percent Of Capital
Gauley National Bank Gauley Bridge, West Virginia	1,271	2,360	185%
Region 6			
Boca Raton National Bank Boca Raton, Florida	7,727	6,385	82%
First National Bank of Cape Canaveral Cape Canaveral, Florida	2,844	4,150	145%
First National Bank of Crestview Crestview, Florida	1,886	1,445	76%
Pan American of De Bary, N.A. De Bary, Florida	1,084	660	60%
Flagship National Bank of Westland Hialeah, Florida	1,277	1,000	78%
Jacksonville National Bank Jacksonville, Florida	✓9,585	7,845	81%
Barnett Bank of Miami Beach Miami Beach, Florida	7,474	5,480	73%
First National Bank of Princetown Princetown, Florida	523	1,480	282%
Region 7			
Columbia National Bank Chicago, Illinois	2,921	2,100	72%
Roodhouse National Bank Roodhouse, Illinois	520	955	184%
Region 8			
First National Bank Mena, Arkansas	1,597	850	53%

Name of Bank (Region 8 cont'd)	Gross Capital Funds	Par Value NYC Bonds	Bonds As Percent Of Capital
First American National Bank North Little Rock, Arkansas	✓ 4,194	2,245	53.5
Region 9			
First National Bank of Fairfax Fairfax, Minnesota	454	450	99.1%
Northfield National Bank Northfield, Minnesota	799	400	50.0%
American National Bank & Trust Co. Eare Claire, Wisconsin	✓ 6,069	5,000	82.4%
Hiawatha National Bank Hager City, Wisconsin	540	280	51.9%
Region 10			
Central National Bank & Trust Co. Des Moines, Iowa	✓ 14,587	14,000	96.0%
National Bank of Caruthersville Caruthersville, Missouri	844	420	49.8%
Region 11			
Farmers & Merchants National Bank Hennessey, Oklahoma	751	560	74.6%
First National Bank in Cameron Cameron, Texas	513	350	68.2%
First National Bank of Cushing Cushing, Texas	473	260	55.0%
First National Bank of Sanger Sanger, Texas	735	500	68.0%
Region 12			
Stockmans National Bank Lask, Wyoming	686	450	65.6%
First National Bank of Powell Powell, Wyoming	2,499	1,850	74.0%

Name of Bank	Gross Capital Funds	Par Value NYC Bonds	Bonds As Percent Of Capital
Region 13			
None			
Region 14			
San Luis Obispo National Bank San Luis Obispo, California	1,911	1,830	96%
Security National Bank Reno, Nevada	10,677	5,513	52%

Possible actions with respect to default by N.Y.C.

CONFIDENTIAL

~~for some (perhaps all) City security holders and for the City's ability to borrow on its own credit, but having little in the way of a broader direct social or economic impact.~~ out

~~Organization of USG Effort~~ ~~Actions~~ ~~Consideration~~ of US govt

Tab B

At the request of the President, Secretary Simon has designated Under Secretary Edwin Yeo as Chairman of the Federal effort. He chairs a steering group consisting of Richard Dunham, Deputy Director, Domestic Council, Roderick Hills, Deputy Counsel to the President, Antonin Scalia, Assistant Attorney General, and Calvin Collier, Associate Director (Economics and Government) of OMB. Robert Gerard of Treasury is acting as staff coordinator.

I. Financial Mechanism.

Insuring a workable mechanism for controlling the financial affairs of the City in the event of default is perhaps the most important priority. An effective mechanism of this nature will in and of itself do much to satisfy the remaining objectives.

The model for such a mechanism is the corporate bankruptcy provisions of existing Federal law. Simply stated, such provisions place in the hands of a Federal judge plenary control over the financial inflows and outflows, as well as the assets, of a debtor.

Existing municipal bankruptcy provisions of Federal law are inadequate in that they require prior written consent of 51% in interest of the city's security holders to a reorganization plan before a Federal court can obtain jurisdiction.

Although certain constitutional provisions are implicated in any revision of the municipal bankruptcy law, it appears possible to amend the law to eliminate the 51% requirement, thus assuring the opportunity for prompt and secure Federal court jurisdiction over the City's financial affairs.

At the same time, there is one loophole in existing law. If default occurs and the City is sued by a security holder, it may seek a Federal stay of such suit by filing, among other things, a reorganization plan and a statement to the effect that there is a "reasonable prospect" that the 51% consent requirement can ultimately be met. Such a stay may be granted for sixty days and extended for an additional sixty days. To effect a permanent solution, the requisite consents would still have to be obtained. The stay route, however, would prevent a major potential source of chaos: a number of legal actions resulting in conflicting injunctions -- e.g. one payment to court ordering note holders, not the police; another ordering the reverse, etc.

Action Required. There is no indication that the City is working on bankruptcy matters. Moreover, we understand that Governor Carey has instructed counsel for MAC to cease their bankruptcy-related preparation. While the Carey report may in fact be intentionally incorrect, we must be prepared on both fronts.

Mr. Hills - Draft legislation for review by steering group by 9/1.

Mr. Gerard - Draft reorganization plan for review by steering group by 9/5.

out

Out

Mr. Scalia - Draft other legal papers required in connection with stay petition under Chapter 9 by 9/5.

Steering Group - to decide by 9/3 as to legislative strategy concerning amendment.

II. Public Order.

In the event of default, the City may be financially unable to meet payrolls. In addition, there is a possibility that the City's mechanism for making payments may cease to function. This poses two threats. First, in the event payrolls are not met (for either reason) or serious uncertainties as to pay develop, a general or partial strike could occur and could involve the police and/or firemen. Second, in the event assistance payments are not made, there could be rioting beyond the capacity of local authorities to control.

Legally, the State has primary responsibility to deal with such matters in the first instance. Accordingly, our preparation must be along two lines. First, we must assess the resources (and the mobilization time required) of the state in this regard. Second, we must assess both our legal authority and practical ability to act, both on the assumption that the State will act and on the assumption that it will not.

Out

Action Required.

Mr. Dunham - Memorandum assessing Federal and State authority and resources by 9/3.

CONFIDENTIAL

out

Steering Group - Decide on 9/3 whether and when liaisons with DOD and the State should be established.

III. Federal Payments.

As suggested above, one potential source of unrest would be an interruption in the flow of Federal payments for welfare, medicaid and other forms of assistance. Two issues are presented. First, what legal impediments exist in the event the City is unable to meet its matching share obligations. Second, how can the USG and/or the State assure continuing flows in the event the City's payment mechanism ceases to operate because of strikes, etc.

OMB ~~Mr. Collier~~ has identified three HEW programs which constitute the bulk of Federal payments potentially affected by a default. With respect to these programs, further work is required in determining the legal implications (primarily as a matter of State law) of the City's possible failure to meet matching requirements. In addition, it is necessary to develop a mechanism to administer these programs in the event of the City's failure to do so.

To date, very little is known about the remaining programs. ~~At the least, enough~~ further information ~~should~~ will be developed to permit a determination whether coverage of such programs is essential to the success of the plan.

out

Action Required.

Mr. Collier - overview of remaining programs by 9/1.

out

Steering Group - Decision by 8/29 concerning whether Mr. Collier should pursue with other USG personnel development of a mechanism for USG or State operation of City assistance programs.

IV. Banking System.

The main threat to the banking system is psychological. ~~A~~ NYC default would not meaningfully impair the capital of any of the major banks. We have identified smaller banks (deposit range to) which could suffer significant or total capital impairment. out The real risk is that such potential failures, coupled with the other uncertainties attending a default, could cause a worldwide lack of confidence in the major U.S. institutions.

Accordingly, we must act to insure that no liquidity problems arise and that bank failures are averted. The Fed has already announced that discount windows will be open. ~~Mr. Yeo has been discussing with the FDIC the possibility~~ ~~of~~ The FDIC will be ready to purchase ~~of~~ convertible capital notes of banks threatened with large capital impairments. To avoid "bail out" charges, such purchases would involve severe penalties for bank officials responsible for the imprudent levels of ownership.

out

Action Required.

Mr. Yeo - Finalize agreement with FDIC by 9/1.

Mr. Gerard - Prepare "Impact on Banking System" statement for possible public release by 9/5.

V. Operation of Essential Financial Institutions.

In the event of civil disorder certain financial institutions -- e.g. New York Fed, Stock Exchange -- may be unable to open due to inability of employees to travel, security concerns, etc. Such closings could impair essential financial operations of the USG and undermine national and international confidence in our markets.

We ~~should~~ are explore*ing* possible contingency action under two assumptions: (1) conditions force a closing of 1-2 days; (2) a closing of longer duration. We will have to identify the specific functions which cannot be interrupted. Alternative means, if any, for performing such functions must be developed.

out

Action Required.

Mr. Yeo - Determine by 8/29 whether, and with whom, liaisons should be established.

Mr. Gerard - Establish liaison, identify functions and formulate alternative plans by 9/5.

VI. Orderly Markets.

Overall order (or disorder) in the capital markets will be largely a function of our success in implementing the other elements of the plan. However, there is one area of special concern. In mid-September, four housing agencies (NYSHFA, NYS Dormitory Authority, New Jersey HFA and Massachusetts HFA) will need to fund out or roll over maturing short term securities. These agencies have recently had difficulties in raising funds in the public market for two reasons. First, overall market uncertainty caused by NYC's problems. Second, lack of understanding of the underlying financial resources of the agencies. Such understanding was less necessary as long as the moral obligation commitment was viewed as a reliable credit basis. In the wake of UDC, this is no longer the case and these securities are generally being looked at as straight revenue bonds.

Our primary concern is with New YORK STATE HOUSING FINANCE AUTHORITY (NYSHFA). Most of the Dormitory Authority's September obligation has been prefunded. Massachusetts and New Jersey have experienced substantially less difficulty than the NY agencies and will be less "tainted" by further adverse events.

~~At Treasury's urging,~~ An indepth review of HFA's underlying financial soundness is being conducted in New York. Although hard, audited, results will not be available in time to meet September's requirements, we do expect to have sufficient information to determine whether notes can be privately placed in September.

~~Assuring the information is relatively positive, Mr. Yeo and HFA representatives will meet privately with bankers during the week of September 1.~~

In addition, consideration should be given to the possibility of employing Section 802 of the Housing Act of 1974. Section 802 permits Federal guarantees of taxable state housing agencies obligations and provides a 1/3 interest subsidy. ~~We do not think this authority has yet been exercised by HUD.~~

end of B

CONFIDENTIAL

Action Required.

Mr. Yeo - by 8/28, decision whether to participate in NYSHFA private placement effort. If yes, arrange meetings for week of 9/1.

By 8/28, decision whether to pursue Section 802 option. If yes, meet ASAP with Secretary Hills.

Mr. Gerard - by 9/2, update on prospects for other agencies.

VII. Other Matters.

A. State Legislative Liaison. The Steering Group will want to consider whether a liaison in Albany (probably with Senator Anderson) would be desirable in connection with the upcoming special session of the legislature. We may be able to help Anderson (and protect ourselves) by providing him with our views as to the merits of the various proposals. If we decide on a liaison, Mr. Dunham would appear to be the best contact.

B. Public Statements. Statements will be required as follows:

1. In the event of default: President, Secretary Simon

2. In the event we decided to announce planning activities: Secretary Simon.

Mr. Yeo will prepare these statements for review by the group.

C. Decisions Required. The following is a chronological summary of the planning decisions outlined above:

-- August 28

1. Action on HFA Private Placement

2. Section 802 option -- HUD contact

-- August 29

1. Collier contact with other USG personnel re takeover of assistance programs

2. Liaison with NY Fed, other institutions re emergency operation

-- September 3

1. Congressional contact on bankruptcy amendement

2. Liaisons with DoD, NY State re preventing unrest

3. Liaison with Anderson

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

AUG 6 1975

MEMORANDUM FOR THE ECONOMIC POLICY BOARD

FROM: Gerald L. Parsky
Assistant Secretary

SUBJECT: Financial Condition of Large Cities Other Than New York

At the Executive Committee's request, we have evaluated the possibility that further deterioration of the municipal market (such as might be caused by a New York City default) might result in cash flow problems for other cities similar to those of New York. We do not believe there is a basis for serious concern.

The sole potential source of concern is the possibility that the municipal market will be closed off to many borrowers. Accordingly, cities that do not need to borrow will not be endangered (although they may be forced to defer capital spending). Cities that need to borrow fall into two classes:

-- those which have issued bond anticipation notes (BANs) to finance capital projects and must refund maturing notes with long term bonds or by rollover;

-- those which must borrow to pay operating expenses.

With respect to the first class, we see little basis for concern, except perhaps in New York State. All New York State issuers have been severely tainted by New York City's problems, but such taint has been principally reflected to date only in price. Rochester, Buffalo and Syracuse do have BANs outstanding. Moreover, in part because of the NYC commitments of all large New York State banks, bank credit may not be as readily available. On the other hand, both Rochester and Erie County (Buffalo's parent jurisdiction) successfully sold BANs on August 5.

Elsewhere, BAN refunding does not appear to be a problem. We have identified no city outside of New York State with in excess of $100 million in BANs outstanding. Even assuming temporary loss of market access, funding for any short maturities should be well within the capacity of the local banks to absorb.

Cities which need to borrow to finance operations in turn fall into two subclasses. In one class, alone, is New York City, which must borrow to finance massive current and cumulative deficits.

The other class includes cities which borrow at one point in a fiscal year to supply cash needs and repay the debt out of revenues due later in the year. Among others, Chicago, Boston and Philadelphia use such a device. Because such borrowers are in a position to pledge an identifiable source of revenue as security, we do not believe they will experience difficulties in obtaining loans, either through the municipal market or through the banking system.

THE WHITE HOUSE

WASHINGTON

August 8, 1975

TO: BILL SEIDMAN

FROM: DICK DUNHAM

Proposed substitute for paragraph 3 of Treasury memo of 8/8

The State Budget Director reported that the net 1976-77 budget imbalance of projected revenues over projected expenditures was $600-800 million.

This projected imbalance does not include $500 million of operating expenses included in the $1.5 billion capital budget.

Therefore, from an accounting standpoint, but not from a legal standpoint, the imbalance is about $1.2 billion. Of course, if funds cannot be borrowed to finance the capital budget items of $1.5 billion later this year the total cash imbalance will be around $2 billion.

Therefore, the City or Big MAC must borrow about $2 billion to cover the current imbalance, the capital budget items and the short term cash flow needs. The total borrowing by one or the other to cover all these needs during the period September until about March of '76 is in the neighborhood of $4-5 billion.

Assuming the City can't borrow on its own, MAC will have to seek an enlargement of its authority from $3 billion to $6 billion to attempt to handle another large portion of the City's cash need.

[8-28-75?]

August 28, 1975

MEMORANDUM FOR THE PRESIDENT

FROM L. William Seidman

SUBJECTQ New York City

John McCloy called to relay Governor Carey's message with respect to the current situation. Governor Carey knows that the Federal Government cannot provide assistance. He does believe that they could be helpful by taking "a less cavalier" attitude. Governor Carey will be meeting with Chairman Burns to discuss this further tomorrow.

McCloy has just returned from Europe where he reports that European bankers and government officials are very concerned about the possible effects upon them of such a default. McCloy also reports that Paul A. Volcker, President of the New York Fed, points out that a default while the IMF is meeting in Washington would be particularly unfortunate.

I told him I would relay the message toyou.

LWS: mk

RBP: Chron

QUESTION: What are your views about the current situation in New York City? Do Chairman Burns recent comments signal a change in the Federal Government's position?

ANSWER: I am of course deeply concerned about New York City's financial condition. In recent weeks, a review of the City's finances by MAC and the State has revealed deficits far larger than were heretofore expected. These levels of deficit mean that the problem must be attacked on two fronts: there must be a credible current budget as well as a longer range plan to eliminate the cumulative burden from past years. But I continue to believe that resources exist at the State and local level to deal with the situation successfully.

As he himself has pointed out, Dr. Burns' recent statements reflect absolutely no change in the Federal Government's position. When Congress created the Federal Reserve System some sixty years ago, providing a mechanism for maintaining the liquidity of our commercial banks was an important objective. And Dr. Burns said nothing more than that the Federal Reserve would perform this traditional role with respect to banks affected by New York, just as it has in so many other cases.

BACKGROUND: The essential distinction which must be kept in mind is between providing liquidity and assuming the risk. When the Fed provides liquidity -- "opens the discount window" -- it looks only to the bank's credit as a source of repayment. If the Fed, on the other hand, were to purchase City or MAC securities from banks, its only recourse would be against the City or MAC: the Fed, not the banks, would bear the risk. The Fed has never said it would purchase City or MAC debt.

Gerald L. Parsky

Gerald L. Parsky
Home: 686-1917
Office: x5164
August 28, 1975