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NEW YORK CITY'S ECONOMIC CRISIS

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

NINETY-FOURTH CONGRESS

FIRST SESSION

SEPTEMBER 24 AND OCTOBER 8, 1975

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE

65-920 WASHINGTON : 1976

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402 - Price $1.70

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(Created pursuant to sec. 5(a) of Public Law 304, 79th Cong.)

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WEDNESDAY, SEPTEMBER 24, 1975

NEW YORK CITY'S ECONOMIC CRISIS

WEDNESDAY, SEPTEMBER 24, 1975

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to notice, at 9:40 a.m., in room 1318, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senators Humphrey, Proxmire, Ribicoff, Bentsen, Kennedy, Javits, Percy, and Fannin; and Representatives Moorhead, Hamilton, Brown of Michigan, Heckler, and Rousselot.

Also present: John R. Stark, executive director; Jerry J. Jasinowski, Loughlin F. McHugh, John R. Karlik, William A. Cox, and Robert D. Hamrin, professional staff members; Michael J. Runde, administrative assistant; George D. Krumbhaar, Jr., minority counsel; and M. Catherine Miller, minority economist.

Chairman HUMPHREY. We will open the meeting of the Joint Economic Committee.

Mayor Landrieu, how many mayors do we have here?

Mayor LANDRIEU. We have nine, Mr. Chairman, and we anticipate three others to come while this meeting is in progress.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. Today, the Joint Economic Committee holds its first in a series of hearings designed to assess the economic and financial impact of New York City's deepening financial crisis, and problems that relate to the financing of our other large municipalities. The hearings are in response to the committee's desire to produce an accurate and analytical assessment of the consequences and the possibilities of a New York City default.

I might add that we have had testimony before from other witnesses that relate to municipal financing and this is in a very real sense a continuation of that. We have met, some of us, privately with the mayors. Not long ago, following the Mayors' Conference and the League of Cities meeting, we had Mayor Alioto and others that are here to visit with us.

Today we will hear testimony, as was indicated by Mayor Landrieu, from 9 or possibly 12 mayors about the recent financial problems they have experienced as a result of the uncertainty created by New York's financial crisis. Subsequent to the mayors' testimony, we will hear from the Honorable William Simon, Secretary of the Treasury. Secretary Simon will be here very shortly.

As can be expected, there is great uncertainty about the economic and financial consequences of default by New York City. There is little precedent in history on which to base our assertions and certainly nothing that approaches the magnitude of New York City. In fact, the only appreciable U.S. experience with municipal government default occurred during the Great Depression, when 4,770 jurisdictions defaulted on one or more of their outstanding securities.

Even so, the dollar amount of affected securities from 1929 to 1937 was only about $1,350 million. Or at that time, 7 percent of the municipal debt then outstanding.

Today, if New York City alone were to default on its securities, just this one city, it would once again represent almost 7 percent of the outstanding State and local debt, and if the State and its agencies were in any way involved, it would be up to 13 percent of the outstanding municipal and local government, State and local government debt. So we are dealing with a problem of unprecedented magnitude and I might say a problem of national significance regardless of what other people in government may think of it.

Yet, it seems that we are confronting an administration, and in some respects, a Congress, which is content to turn the other way and regrettably bury its head in the sand. It is an attitude that I, and many others, find difficult to understand.

When I spoke to the International Economic Association over the August recess, many of the participants expressed shock that the Federal Government was doing nothing to assist America's largest city and one of the world's great urban centers. They simply could not understand how the richest and most industrialized Nation in the world could allow such a tragedy. It certainly is difficult to come up with an explanation, but I finally conclude that most elected officials had decided that this was a New York problem that did not affect their constituents directly or indirectly.

I think it is obvious today that your presence here today and your discussion with the President this afternoon are direct testimony to the contrary. They indicate to me and to others in Washington that New York's financial problems are not confined to the five boroughs within the city limits. It is not statesmanship that brings you here today, but enlightened self-interest.

Clearly, New York's problems have had a profound effect on the ability of most large cities to borrow in the municipal bond markets at any reasonable rate of interest. I share your concern that the national economic and financial consequences of a New York City default could be and may be severe.

For this reason, the Joint Economic Committee of the Congress intends to examine in greater detail the true economic impact of New York's financial crisis. As part of this effort, we intend to examine the various avenues through which the Federal Government could provide assistance to avert default or minimize its impact. The committee's investigation will include public hearings, such as the one today, communications with various Government agencies, a staff study, and legislative recommendations.

As you know, as chairman of this committee, I have addressed communications to the Chairman of the Federal Reserve, Mr. Burns, and to the Secretary of the Treasury, Mr. Simon. Those communications will be made a part of the record, including their responses.

[The letters follow:]

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., September 5, 1975.

Hon. ARTHUR F. BURNS,
Chairman, Board of Governors, Federal Reserve System,
Federal Reserve Building, Washington, D.C.

DEAR MR. BURNS: As Chairman of the Joint Economic Committee I have become increasingly concerned that New York City's deepining financial crisis will have profound adverse implications for other major cities and quite possibly for other major sectors of our economy. However, I have seen no significant and thorough analysis assessing the full economic impact of a default either to allay my suspicions or to confirm my fears.

In response to this gap in information, I have asked the staff of the Joint Economic Committee to examine in greater detail the economic implications of a default by New York City and also to review the efficacy of various proposals to lessen the adverse economic impact. As part of this effort the Committee and its staff will discuss these important issues with experts around the country.

In order to provide the Congress with an accurate and complete description of this problem, it is essential that the Committee receive the Federal Reserve Board's assessment of the economic impact of a New York City default and any analysis of this situation that has been prepared by the Federal Reserve Board staff. Specifically we would like you to assess, in as analytical terms as possible—the impact of a full or "partial" default on the market for tax exempt securities issued by other municipalities, particularly large cities; the impact of a full or partial default on the market for tax exempt securities issued by states, particularly New York State; the impact of a full or partial default on bank liquidity and the financial stability of the banking system; the impact of a full or partial default on the strength of economic recovery, focussing particularly on the economic impact of declines in investor confidence and on caution by lending institutions; and the impact of a full or partial default on other money markets, particularly the corporate bond market, and on the stock market.

It would also be helpful if you could supply the Committee with any contingency plans that the Federal Reserve Board is prepared to undertake to either ameliorate the possibility of default or to minimize the economic impact of default. If specific actions have been rejected, either to prevent default or to minimize its impact, it would be helpful if you could provide an explanation for the rejection.

Since the financial situation of New York City is becoming more serious by the day, the Committee would appreciate as prompt a response as is possible. I hope that you will be able to provide us with your assessment of this situation by Friday September 12.

I greatly appreciate your efforts in responding to the Committee's request.

Sincerely,

HUBERT H. HUMPHREY,
Chairman, Joint Economic Committee.

CHAIRMAN OF THE BOARD OF GOVERNORS,
FEDERAL RESERVE SYSTEM,
Washington, D.C., September 10, 1975.

Hon. HUBERT H. HUMPHREY,
Chairman, Joint Economic Committee,
U.S. Congress, Washington, D.C.

DEAR MR. CHAIRMAN: Your letter of September 5. 1975 raised several important questions relating to the financial problems of New York City. Fortunately, since receipt of your letter, the urgency of these problems has been considerably lessened as a result of the aid package enacted by the New York State legislature. The municipal market has reacted favorably to this development, and prices of bonds issued by the Municipal Assistance Corporation have risen.

The improvement in the outlook for New York City's finances is heartening. Nevertheless, the Federal Reserve would not have fulfilled its responsibilities if we had not developed contingency plans that would be applicable in the event of a default.

The Federal Reserve is the nation's lender of last resort. I and other members of the Board have given repeated assurances that the Federal Reserve will act promptly to relieve liquidity strains on the banking system, whatever the cause of those strains may be. Thus, a bank that is in a basically sound condition would be eligible for prompt assistance from the Federal Reserve in the case of a temporary liquidity problem. And, as you are aware, the System also has broad powers to stabilize markets through open market purchases of U.S. Government securities.

The Board has carefully considered the implementation of contingency plans for lending to banks through the discount window in case financial strains develop as a result of default by a major municipality. The Board has agreed that funds would be made available on whatever scale is deemed necessary to assure an orderly financial environment. The credit thus extended to member banks would supplement normal borrowings at the discount window. Credit at a higher discount rate could also be extended to nonmember banks that find it impossible to obtain necessary assistance elsewhere.

The Board recognizes that sizable extensions of Federal Reserve credit run the risk of leading for a time to a greater expansion in bank reserves and money supply than is consistent with longer-run monetary objectives. Clearly, any such expansion must be only temporary. Growth in bank reserves would soon be reduced to a moderate rate, either as a result of offsetting open market operations or as temporary bank borrowing was repaid.

There are also certain supervisory and examination questions that may arise with respect to banks in the event of a possible municipal default. In this connection, the Board and other bank regulatory agencies have plans to revise procedures that would apply to the valuation of defaulted securities, so that some time would be available for the market for such securities to stabilize and to permit the issuer to develop a fiscal program that may eliminate the default.

Our long-standing contingency plans have been adapted in light of emerging conditions. The municipal as well as other markets have long been aware of the New York City problem. Last week—when expectations of a New York City default were widespread—yields on state and local government securities reached, on the average, a record high.

Investors have also become increasingly selective. Since the beginning of the year, yields on lower-rated municipal bonds have risen substantially more than on higher-quality issues. Reflecting the problems of New York City, bonds issued by the Municipal Assistance Corporation have been trading at much higher yields than other comparably rated issues. Recent yields on high and lower quality municipal securities, as well as on the Municipal Assistance Corporation bonds, are displayed in the attached tables. The widening yield spread suggests that the market probably had to a significant extent discounted the possibility of a default by New York City.

Moreover, many cities and states have already taken strong measures to reduce spending and increase taxes. These developments suggest that the disciplines of the market place have already been working to limit potential disturbances from a default.

In view of their responsibilities in the banking area, I am sending copies of this letter to the Chairmen and ranking minority members of the House and Senate banking committees.

Sincerely yours,

ARTHUR F. BURNS.

Enclosure.

YIELDS ON MUNICIPAL ASSISTANCE CORPORATION BONDS [1]

[In percent]

	Issued July 2		Issued Aug. 15.—
	Maturing [2] 1985	Maturing [3] 1990	Maturing [4] 1983
August:			
18	10.74	10.85	11.05
19	10.74	10.82	10.76
20	10.74	10.85	10.76
21	10.87	10.89	10.80
22	11.01	11.00	10.95
25	10.90	11.00	10.95
26	10.90	11.04	11.00
27	10.90	11.00	10.86
28	11.29	11.28	11.05
29	11.19	11.32	11.05
September:			
1	(5)	(5)	(5)
2	11.57	11.60	11.19
3	11.76	11.76	11.25
4	11.67	11.76	11.34
5	11.10	11.36	10.90
8	11.01	11.17	10.86
9	10.65	10.97	10.72
For week ending: [6]			
July 25	10.44	10.70	
August:			
1	10.26	10.65	
8	10.22	10.52	
15	10.67	10.82	
22	10.82	10.88	10.86
29	11.04	11.13	10.98
September 5	11.53	11.62	11.17

[1] Yields shown are based on bid price quotations in the secondary market. Bonds issued on July 2 began trading in the secondary market on July 21.
[2] Initial offering yield—9.00 percent; coupon—9.00 percent.
[3] Initial offering yield—9.50 percent; coupon—9.25 percent.
[4] Initial offering yield—11.00 percent; coupon—11.00 percent.
[5] Holiday.
[6] Weekly average of daily figures.

Source; Daily bond buyer.

MOODY'S MUNICIPAL BOND YIELDS

[Monthly average of weekly data, percent]

	Aaa	A	A less Aaa
1975:			
January	6.39	7.13	.74
February	5.96	6.53	.60
March	6.28	6.79	.51
April	6.36	7.09	.63
May	6.42	7.13	.70
June	6.28	7.36	1.08
July	6.39	7.50	1.11
August	6.40	7.55	1.15
For week ending:			
May:			
1	6.40	7.15	.75
8	6.35	7.05	.70
15	6.35	7.05	.70
22	6.50	7.20	.70
29	6.50	7.20	.70
June:			
5	6.35	7.33	.98
12	6.15	7.25	1.10
19	6.30	7.40	1.10
26	6.30	7.45	1.15
July:			
3	6.30	7.45	1.15
10	6.33	7.47	1.14
17	6.40	7.50	1.10
24	6.50	7.58	1.08
31	6.40	7.48	
August:			
7	6.40	7.55	1.15
14	6.40	7.55	1.15
21	6.40	7.55	1.15
28	6.40	7.55	1.15
September 4	6.60	7.70	1.10

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., September 5, 1975.

Hon. WILLIAM E. SIMON,
Secretary, Department of the Treasury,
Washington, D.C.

DEAR MR. SECRETARY: As Chairman of the Joint Economic Committee I have become increasingly concerned that New York City's deepening financial crisis will have profound adverse implications for other major cities and quite possibly for other major sectors of our economy. However, I have seen no significant and thorough analysis assessing the full economic impact of a default either to allay my suspicions or to confirm my fears.

In response to this gap in information, I have asked the staff of the Joint Economic Committee to examine in greater detail the economic implications of a default by New York City and also to review the efficacy of various proposals to lessen the adverse economic impact. As part of this effort the Committee and its staff will discuss these important issues with experts around the country.

In order to provide the Congress with an accurate and complete description of this problem, it is essential that the Committee receive the Administration's assessment of the economic impact of a New York City default and any analysis of this situation that has been prepared by the Department of Treasury staff. Specifically we would like you to assess, in as analytical terms as possible—the impact of a full or "partial" default on the market for tax exempt securities issued by other municipalities, particularly large cities; the impact of a full or partial default on the market for tax exempt securities issued by states, particularly New York State; the impact of a full or partial default on bank liquidity and the financial stability of the banking system; the impact of a full or partial default on the strength of economic recovery, focusing particularly on the economic impact of declines in investor confidence and on caution by lending institutions; and the impact of a full or partial default on other money markets, particularly the corporate bond market, and on the stock market.

It would also be helpful if you could supply the Committee with any contingency plans that the Administration is prepared to undertake to either ameliorate the possibility of default or to minimize the economic impact of default. If specific actions have been rejected, either to prevent default or to minimize its impact, it would be helpful if you could provide an explanation for the rejection.

Since the financial situation of New York City is becoming more serious by the day, the Commitee would appreciate as prompt a response as is possible. I hope that you will be able to provide us with your assessment of this situation by Friday September 12.

I greatly appreciate your efforts in responding to the Committee's request.

Sincerely,

HUBERT H. HUMPHREY,
Chairman, Joint Economic Committee.

THE SECRETARY OF THE TREASURY,
Washington, September 16, 1975.

Hon. HUBERT H. HUMPHREY,
Chairman, Joint Economic Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: I am writing in response to your letter of September 5, 1975, requesting an analysis of the potential impact of an inability by New York City to meet its obligations as they mature. It is clearly appropriate that we fully evaluate the potential consequences of such an event and the methods available for dealing with them.

As you know, I shall be testifying before your Committee on the 24th of September on many of the questions that you have raised, and in that testimony I plan to cover these issues in full detail. In the meantime, in order to be responsive to your needs as well as those of your colleagues, I would like to offer brief comments on each of the points that you have mentioned.

FINANCIAL MARKETS

As I have said many times in commenting upon the possible impact of a default by New York City upon our financial system, we are dealing in the realm of personal judgments; absolute certainty is simply not possible. Based upon past experience, however, I have great faith in the resiliency of our financial markets and, subject to the willingness of most market professionals to view the situation objectively, I believe those markets are capable of handling a default with no more than moderate and relatively short-lived disruption. I must add that to some extent, the possibility of a New York City default has already been discounted in the marketplace. Although a variety of complex factors have contributed to the current high levels of tax-exempt yields, one element is the expectation of a New York City default. Accordingly, if default were to occur, we would expect only a moderate degree of further adjustment.

OTHER ISSUERS OF TAX-EXEMPTS

New York City's well publicized difficulties have clearly resulted in more intensive scrutiny of the underlying soundness of all tax-exempt credits, a healthy development in our view. We would expect the levels of care employed in analyzing potential tax-exempt investments to rise even further in the event of a default, in effect rewarding issuers whose financial affairs are entirely in order. We do not believe, however, that any other issuer will default as a direct consequence of a default by New York City.

BANKING SYSTEM

As the Committee is aware, the Treasury Department along with the bank regulatory agencies has reviewed the exposure of the banking system in the event of a default by New York City. Based upon that review, we have concluded that a default would not cause solvency problems for any major bank. We have identified certain smaller banks which may face material capital reductions as a result of a default. These few banks are being carefully watched by the appropriate regulatory agencies, which will take the necessary steps to insure that no innocent parties are adversely affected by the impact of a New York City default on certain banks.

OVERALL ECONOMIC OUTLOOK

As a result of widespread publicity, the nation is fully aware of the financial situation in New York City and is particularly sensitive to the unique aspects of the situation; specifically, the city's massive deficit spending. Given these levels of awareness, we do not believe a default would undermine fundamental confidence in our economy or cause financial institutions to adopt unnecessarily restrictive credit policies.

Indeed, just the contrary may be true. If the Federal government were to act to prevent default—by guaranteeing New York City or MAC debt, for example—there is a serious risk that the capital and the credit markets would react adversely. The expansion of the Federal credit involved would have a measurable impact on borrowing costs throughout the capital markets, and would exacerbate the market access problems of marginal issuers. And any attempt to compensate through a relaxation of monetary policy would fuel expectations of future inflation, strengthening investor reluctance to commit funds for the long term.

In recent weeks, many prominent figures, including a number of leaders of the financial community, have predicted that a default could place an intolerable degree of strain upon our financial system, and possibly upon the whole of our society. As I indicated earlier, absolute certainty with regard to the possible repercussions of a default is simply not possible. Nonetheless, there would appear to be little objective evidence to support such conclusions. Indeed, I am deeply concerned about some of these statements because I believe they increase the element of risk to our financial system. Accordingly, as we work together in seeking the best possible outcomes to this matter, it is essential that all parties concerned exercise restraint and sound judgment with due regard to the importance of the issues at stake.

Until we meet on the 24th, my staff stands ready to continue working with the Members and staff of the Joint Economic Committee in exchanging factual and other information.

Sincerely yours,

WILLIAM E. SIMON.

Chairman HUMPHREY. As part of this effort, we greatly appreciate your willingness to testify before the committee, to acquaint Congress and the public with your recent financial experiences. Members of the U.S. Conference of Mayors, we welcome you, and as I understand it, Mayor Moon Landrieu, of New Orleans, will be the coordinator of this testimony.

Senator Javits wants to have a comment.

Senator JAVITS. Just one word, gentlemen. I join in welcoming you on behalf of the minority. I wish to add only this. There has been a lot of loose talk about bailouts. I hope that you will strongly deal in your testimony with that point. No one that I know of in New York City is asking the Federal Government to bail New York City out of its past misdeeds. We have suffered and we will suffer for them. What we are asking is that the city not be allowed to sink and go into default dragging with it enormous interest on the part of the municipalities of the United States and the national economic system.

Thank you, Mr. Chairman.

Chairman HUMPHREY. Thank you. Any other comments? Senator Ribicoff.

Senator RIBICOFF. Mr. Chairman, I am shocked at the callousness of the present administration in its attitude to the problems of New York City and our municipalities. This isn't just a New York City problem.

I have a front page story of a recent edition of the Bridgeport Post, in Connecticut, and I read the first paragraph:

> New York City's financial troubles already have cost Connecticut $1,700,000. In Oregon, 3,000 miles away, officials complain their State was slapped with higher than normal interest rates.

May I say, when you meet with the President, gentlemen, I think you have a right to point out to him that your cities are bearing many unfair burdens that are basically national in scope.

In 1971 when we were talking about welfare reform, it was my contention that the problems of welfare are national, and they are not local or statewide. We have some 1,150 different jurisdictions who handle the problems of welfare. New York City has an unusual burden of picking up about 25 percent of its welfare costs and the problems of New York City's welfare aren't just New York City's. Everybody with problems has seen an exodus of their problems to the big cities of America, including New York, and your burdens are great. There is no question in my mind that because welfare is national, because of national trends in economics, there should be uniform standards and uniform eligibility rules to handle the problems of welfare.

Now, from my experience as Secretary of HEW, as a Governor, and as a Senator, you are not going to have welfare reform unless a President of the United States is willing to stand up and fight for it, not just talk about it, but fight for it, not run away from it. And I think you have got a right to ask the President of the United States to take the lead in welfare reform and take this burden off the shoulders of your respective communities.

Furthermore, when it comes to problems of education, every child in our respective States is entitled to an equally good education, but yet there is great diversity, and this is a problem, too, of the States and this is a problem of the national Government.

Personally, I am shocked at the indifference and callousness concerning New York's problems. Let us not kid ourselves. There is a prejudice against New York City. But that prejudice against New

York City, throughout the country, and in the halls of Congress, really will boomerang against every city in America. You cannot isolate one or two communities in this Nation without having a rolling and rippling effect across this Nation.

It becomes important for your men to holler, to make your points of view known to your Congressman, your Senators, and your President. The problems of your cities, gentlemen, are problems for all of America. Destroy the core of our urban society and you destroy the entire United States.

Chairman HUMPHREY. Senator Kennedy.

Senator KENNEDY. Mr. Chairman, I want to thank you for inviting the mayors to this hearing, and also to thank the mayors for making their views known not only here to our committee, but also to the President.

One of the most important issues that we are going to face as a Nation for the rest of this century is how we are going to make the cities of the Nation livable places once again. Eight percent of the American people live in the inner cities and in the metropolitan areas. Yet we have seen, in the recent lack of consideration of assistance for New York City, in its opposition to countercyclical revenue sharing, the abandonment of the administration of any responsibility to provide assistance to the cities.

I would agree with those members on this committee, on both sides of the aisle, that feel that we have to work with the cities to devise some means to make the cities livable places again, to provide city residents with quality education and decent health care, to make them safe and free from crime and drugs and fear, to make the cities whole again.

We have heard a great deal about the whole issue of white flight, Mr. Chairman. We hear about it now, as my own city is undergoing a painful experience and is trying to adjust to a court order. But it isn't just the questions of education. It is the question of health, it is the question of jobs, it is the question of housing. It is the whole range of different services that have to be provided if we are going to restore life to our cities.

So I welcome the ideas and the suggestions that will be offered by the mayors here today. I feel that this is going to have to be one of the top issues that ought to be talked about now and over the period of these next several months. We, as a Congress, have to be willing and prepared to meet our responsibilities in helping the mayors meet theirs.

Senator BENTSEN. Mr. Chairman, if I might——

Chairman HUMPHREY. Yes, Senator Bentsen.

Senator BENTSEN. May I just say that Congressman Moorhead is Chairman of our Urban Affairs Subcommittee. We are indebted to the Congressman for his leadership in these matters. A study was done by his subcommittee and the staff of the committee some months ago and is the subject of the lead article in the Wall Street Journal this morning.

Representative MOORHEAD. Mr. Chairman, I was going to ask unanimous consent to have that article made part of the record, because it does report on the activities of this committee and that subcommittee and on the subject matter of the hearing today.

Chairman HUMPHREY. Thank you, It will be done.
[The article follows:]

[From the Wall Street Journal, Sept. 24, 1975]

WORKING THE STREET: STATES TRY HARDER TO PERSUADE BUYERS THAT BONDS ARE SAFE

NEW YORK WOE THREATENS ALL MUNICIPALS, ALTHOUGH SOME STATES GET RICH—GOVERNOR MAKES A PITCH

(By Tom Herman and Byron Klapper)

NEW YORK.—If you attended Maryland Gov. Marvin Mandel's little get-together at Chase Manhattan Bank yesterday afternoon, you have learned that Maryland is not now, and never will be, New York.

Some people may think that obvious, and it would be, except for the extraordinary turbulence in the world of municipal finance these days.

New York City's heralded woes have reverberated throughout the economy, jolting investor confidence in heretofore unimpeachable financial instruments. That was the reason for yesterday's meeting. Maryland is enjoying sizable surpluses, and its securities have the highest possible credit ratings. Yet Gov. Mandel with other top state officials, invited bond traders and investors to Auditorium A at the Chase to assure anyone willing to listen that, as he put it. "There is absolutely no way what is happening in New York could happen in Maryland."

Maryland's concern, despite its general prosperity, is shared by many state governments. Few are as shaky as New York City, but they still have lost their reputations as bastions of fiscal impregnability. Although some states, like Maryland—but most conspicuously, those with a lot of oil or agriculture—are still piling up big surplus, many others have run into grave trouble and have cinched their fiscal felts tighter than at any other time since the Depression.

NORTHEAST, SOUTH HIT WORST

Money problems in some states have been building for years. But they largely have gone unnoticed because of the focus on the nation's metropolitan areas, especially New York. A detailed congressional study last spring found "severe financial problems" in many states, especially in the industrial Northeast and in the South, places where the recession has thrown unusually large numbers of people out of work. Many of the states in these regions have slashed services and payrolls, frozen hiring, put off construction and raised taxes.

The congressional survey, made by the urban affairs subcommittee of the joint economic committee of the Senate and the House of Representatives found that 48 states had a net surplus of $3.9 billion at the end of June. Thirteen energy-producing states and eight other states rich with agricultural income produced most of that surplus. In sharp contrast were 18 states with unemployment rates equal to, or above, the national average. Their combined net surplus shrank to $400 million at the end of June from $2.3 billion a year earlier—a huge reduction—and several of the states were deep in the red.

The $400-million surplus the congressional study observed, "is hardly an adequate cushion in present economic circumstances." For some states, it has meant painful reductions in the quantity and quality of such services as schooling and assistance to the poor. Even when dollar spending on such services has remained high. It certainly has not kept up withr inflation. Ralph I. Schlosstein, the economist who supervised the congressional study, adds that these states are in "the worst squeeze they've faced since the 1930s."

Yet, so sharply have the fortunes of individual states differed that it is sometimes hard to accept that they are part of the same economic structure. While New York, Connecticut and Massachusetts ran up big deficits, Texas rolled up a $1 billion surplus at the end of its fiscal year ended Aug. 30. The Texas legislature raised state employes' salaries by as much as 24% and increased state aid to local school districts by $700 million, assistant state treasurer Jim Oliver says.

BOND RATERS ARE COURTED

"There appears to be a real mismatch of fiscal resources and service needs," Rep. William S. Moorhead (D., Pa.), chairman of the urban affair subcommittee, testified. There are other anomalies. Many states are raising taxes or considering doing so to eliminate deficits, as required by their constitutions yet the federal government is trying to stimulate economic recovery with tax cuts and deficit spending. "For the taxpayer," a Chase Manhattan Bank newsletter says, "what one hand gives, the other takes away."

The organizations that grade the quality of state and local government securities are concerned over debt and budget deficits. "It's easy enough to borrow and hard to raise taxes to balance budgets," says Jackson Phillips, who supervises municipal-bond ratings for Moody's Investors Service Inc. Moody's recently lowered its ratings for New Jersey's and Massachusetts' securities, and it is closely watching fiscal developments in another dozen or so states, including New York, Connecticut, Delaware and Pennsylvania.

As a consequence, the states are trying to cozy up to the nation's municipal-bond graders. "I've been doing this (bond rating) for 35 years, and until a year or so ago I didn't know what a governo rlooked like," says John K. Pfeiffer, vice president of Standard & Poor's Corp.'s bond division. "But now they're really beating the bushes. I've seen nine already this year, Gov. Shapp (of Pennsylvania) came (to New York) twice, but I'm only counting him once. They're really putting on a sales pitch now."

Standard & Poor's this year lowered its ratings on Connecticut's and Massachusetts' securities, and Mr. Pfeiffer says he is keeping "a close watch on other states."

The reasons for the money crunch are clear. Recession and inflation have cut tax revenues and jacked up costs, at the same time that the demand for welfare and other expensive services has risen.

Investors, aware of the situation, have become less willing to lend states money by buying municipal bonds (state bonds are called "municipals," too). To attract buyers, the states are having to pay interest rates that, on occasion, have neared 9%, extremely high considering that the interest payments are tax-free to investors and that a married couple with taxable income of $20,000 a year would have to earn 13.2% in taxable interest to keep a 9% payout.

The big buyers of tax-free securities, commercial banks and fire and casualty insurance companies, have lost much of their appetite for municipals at a time when money-hungry states are offering them in record volume.

New York City's experience has made investors more distrustful of governmental accounting. It is much easier to understand a corporation and perceive its risks than a state," says Amos T. Beason, senior vice president of Morgan Guaranty Trust Co. "Investors are showing their distrust by being very selective about what they buy."

Some federal aid to the states may be in the works. The Senate last summer passed a bill to funnel federal money to states and localities where unemployment is especially high, part of a broad public-works bill. But the fate of the bill in the House of Representatives is uncertain. Equally uncertain is the future of the government's general revenue-sharing with states, due to expire at the end of next year.

State and local government costs are, in some places, being reduced. One study has showed that states and local government payrolls rose to 11.4 million people from 7.2 million over the 1963–73 decade to become the fastest-growing segment of the nation's work force. That is changing. Layoffs and attrition are holding payrolls down.

Some states have become real pennypinchers. New Jersey, for example, is saving $5,000 a year by doing without erasers on the 537,000 ballpoint pens it purchases. Massachusetts state officials have given up their cherished limousines, Gov. Michael S. Dukakis now rides the subway to work and he has cut his personal staff to 53 persons from 118.

Since Jan. 8, New York state's permanent work force has fallen by 5,820 employes to 178,017. Connecticut has cut its payroll by 800 employes and imposed a moratorium on new capital spending commitments.

Maryland, as Gov. Mandel is eager to tell you, is in fine shape. But state officials are trying to avoid paying a higher rate of interest on an $85.9-million bond issue up for sale next month than they did in July, when they borrowed at 5.9%. "We want to explain to people that just because our neighbor is sick, we are fine, and there's no chance of our catching his illness," the governor says.

Louis L. Goldstein, Maryland's comptroller, accompanied the governor to New York. He says Maryland wound up its fiscal year with a general fund surplus of $16,510,000. He says the state hasn't raised its sales tax since 1969 and its income since 1967. And, he observes, he and an assistant spent Monday night in New York at a relatively modest, $25-a-night (including parking), out-of-the-way hotel, doubling up in the same room.

Gov. Mandel says Standard & Poor's suggested he come to New York and make his pitch. Standard & Poor's says it did make the suggestion, and it thinks other governors should do the same. "They've got to tell their stories and answer questions," a spokesman says. "Otherwise, no one will be interested in their securities."

Representative MOORHEAD. I welcome the mayors and hope they still support and will do a little work on that Intergovernmental Anti-recession Assistance Act.

Chairman HUMPHREY. Senator Bentsen.

Senator BENTSEN. Thank you, Mr. Chairman, and I want to congratulate you on calling these hearings, and having the participation of the mayors. I am pleased to see that the mayors in their opening statement are not asking for a bailout but would require assurances that any securities that were purchased by the Federal Government would be repaid.

I think that point has to be clearly made. What we have seen across this Nation and in my own State of Texas are the highest municipal bond rates this country has ever seen. We have seen it in Austin, Tex., and have seen it in Arlington, Tex.

So, the impact of this problem exists throughout the Nation. We share your concern in trying to bring about a resolution of this and I congratulate you again, Mr. Chairman, on your efforts.

Chairman HUMPHREY. Mayor Landrieu, we welcome your testimony. Go right ahead.

STATEMENT OF HON. MOON LANDRIEU, MAYOR, CITY OF NEW ORLEANS, LA.

Mayor LANDRIEU. Thank you very much, Mr. Chairman, and gentlemen of the committee. We appreciate the opportunity to present the views of the mayors that form the executive committee of the U.S. Conference of Mayors.

You will note, as I introduce each mayor, that we do indeed represent a cross section of the United States, both in terms of geography and in population bases.

We have with us this morning Mayor Kenneth Gibson of Newark, N.J., the vice president of the U.S. Conference of Mayors; Lee Alexander of Syracuse, N.Y., who is chairman of the advisory committee; Mayor Joseph Alioto, San Francisco, who is immediate past president; Mayor Henry Maier of Milwaukee, Wis.; Mayor Jack D. Maltester, of San Leandro, Calif.; Mayor Dick Hatcher of Gary, Ind.; Mayor William McNichols of Denver, Colo.; Mayor George M. Sullivan of Anchorage, Alaska; Mayor Abraham Beame of New York; and Mayor Coleman Young of Detroit, Mich.

We anticipate during the course of these hearings that Mayor Ralph Perk of Cleveland will be present, as well as Mayor Carlos Romero Barcelo and Mayor Kevin White, who had an election yesterday in Boston and I understand quite successfully.

We are here, Mr. Chairman and gentlemen of the committee, because we are concerned about this country, and we are concerned about our cities and we are concerned about the 8 million people who live in New York City. We have been before many, many committees of Congress and have had many visits to the White House. We expressed the great danger in which we find many of the cities of this country. We have tried repeatedly to warn the national leadership that there are many cities in this Nation that cannot possibly support themselves, that the very social and economic changes that have taken place in this country make it virtually impossible for many of the older, larger metropolitan cities to continue to support themselves, as well as the metropolitan areas that have grown around them.

I do not speak as an expert on any particular subject except I do know something about my city, and that is a city of some 600,000 people that is losing population and the population that is left in that city is older and poorer than it was 10 years ago. And it continues to support the services not only for itself, but now for another 600,000 people who live on its borders.

We have been restricted by various State legislative acts. We have been mandated by various legislative acts of the State and the Federal Government, and various judicial decrees to upgrade certain services, to improve facilities, and to do a multitude of other things without a concern of where the money is coming from.

As a long-range problem, there are many of us that foresee that without additional Federal and State help, that we are not going to be able to survive, and that is not an overly dramatic statement. It is very apparent to most of us.

But, today we are here because the premier city of this country, one of the great cities, if not the greatest city in the world, one of the strongest cities in the world, if not the most significant and economically strongest city in the world, is in dire straits and on the verge of collapse. We are concerned about the impact of that collapse, not only on the people of New York City, but on the people of New Orleans and on Detroit, on Cleveland, and on San Francisco, and all over this country. We are concerned that the collapse of New York City or default by New York of its obligations will make it difficult, if not impossible, for any city to borrow money.

Surely, impact is already being felt.

We are also concerned, Mr. Chairman, that New York City, which is the financial center of this Nation, and to which city we all look not only for financing but for ideas, for cultural, for entertainment, to have a fantastic impact on all of our institutions separate and apart from the governmental agencies themselves. It strikes us very strange that New York City, with the great contribution it has made to this country, being the major port of this Nation, being the port of entry for the vast numbers of immigrants who today are productive Americans, finds itself in a short cash position and so many are quick to suggest that it be abandoned.

Well, I suggest to you that there isn't a mayor at this table that takes that view. New York City is much larger than the city of New Orleans and much stronger economically, but we are here today pleading with you to find some method to assist New York to assist itself. We are satisfied that New York has the economic viability to work its way out of this problem if it can have some immediate assistance in borrowing money.

I don't know that there is not a person in the United States or a government or a corporation that hasn't, at one time or another, had to borrow money. If the Federal Government couldn't borrow money this year, the Federal Government would be bankrupt. If the Federal Government's notes were called at this point in time, without a period to adjust your financial posture, the Federal Government would be bankrupt.

And so it is true with New York City. New York needs some breathing time. New York is not here as a supplicant. It is not here for a handout. It is not asking for anything that we haven't done repeatedly for private enterprise or asking the Federal Government to do that which it hasn't done, indeed, for itself. We are here asking that New York be given the opportunity to straighten its affairs out. It matters little why New York is in this situation. I think there is enough blame for all of us to go around.

I think we can presume, if you will, that perhaps all hasn't been right with New Orleans or with Syracuse or with New York or with Baltimore, or with any State government or with the National Government. The important thing is that great strides have taken place in New York City. Great emergency measures and stringent measures have been taken in order to put their affairs in order. And it would indeed be tragic to this Nation if New York defaulted on its bonds and they couldn't meet their payroll.

We are trying to convince the rest of the world right now that this Nation is going through a period of adjustment, but it is still the strongest, most democratic Nation in the world. I dare say that we will convince no one if this Nation doesn't have the wherewithal nor the determination nor the will to save the No. 1 city in this country.

I can assure you that in my judgment every foreign nation will interpret the failure of New York City as the failure of the United States of America. What an impact that would have on our international relations. And I suggest that if our commitment to our own people, to our own cities, goes no deeper than simply a passing verbal regret to New York, then how do we impress any other nation with our commitment to a free and an economic society?

Mr. Chairman, I would like at this time to ask Mayor Beame to state to you the problem, as he sees it, in New York City, and the type of assistance that he feels he needs. I think you will see from this request that we are not asking, as you pointed out, for a bail-out of New York City. We are simply asking that New York City be given the opportunity to solve its short-term problem and that together we all work to solve the problems of the cities of this Nation.

Mayor Beame.

Chairman HUMPHREY. Thank you very much, Mayor Landrieu.

Mayor Beame.

STATEMENT OF HON. ABRAHAM BEAME, MAYOR, CITY OF NEW YORK, N.Y.

Mayor BEAME. Thank you, Mr. Chairman, and distinguished members of the committee.

First, I want to express my very deep appreciation for this opportunity to present some information to this committee, and I want to underline——

Chairman HUMPHREY. Just speak up good and loud, Mr. Mayor.

Mayor BEAME. I want to underline what some of the members of the committee have said and what Mayor Landrieu has said.

New York City is not seeking a hand-out. As a matter of fact, I think most of you know New York City actually probably sends some $14 to $15 billion to the Federal Government and gets back a little over $2 billion's so we are doing our share in keeping this country together, and that our city's greatness is undoubtedly known to all of you. Sixty percent of all the people of America, at one time or another, can trace their beginnings to the gateway of hope, which has been New York City.

We have been told that the city and the State should take care of its own problems. Well, we have. The State, several weeks ago, enacted legislation which will make available to New York City a little over $2 billion coming from State advances, as well as the use of funds out of public pension systems and other sources which will take us through November 30.

In connection with that legislation, there was created an emergency control board in which I consented to give up fiscal powers that the mayor has, because I felt that that legislation was important in order that we have the wherewithal to render services to the people of our city.

Standard & Poors has indicated, in terms of the State, that if they do anything much further than that, their fiscal integrity is going to be in danger. So that from the State's point of view, they have done all they could without jeopardizing some of their own problems.

Now, the city of New York, in these last few months, has done what normally would be expected to be done over a period of years in terms of setting our house in order. We have made tremendous sacrifices. We have cut our services, our budget, by a billion, which included $400 million reductions due to layoffs of city employees. We have instituted a wage freeze. We have gotten out of the contracts of the unions benefits which they have fought for years to acquire. We have committed ourselves to a ceiling on expenditures over the next 3 years, not in excess of 2 percent of our controllable expenditures.

We have increased the fare in the city of New York despite the fact that it was a very bitter pill for me to swallow by reason of the fact that we fought so hard among the mayors to get a Federal transit subsidy to keep the fares down.

We have increased the fares from 35 to 50 cents, an increase of 43 percent. We were told that, well, why should the city of New York have free tuition, which has been in existence in the city of New York for 128 years in our colleges? Nevertheless, we tried to get the higher education board to change the policy and cut their appropriations the equivalent of the amount of free tuition.

Now, of course, they have the power to continue it, but they are going to have to do something to adjust to that reduction.

We have set up a management board, consisting of some of the outstanding corporate executives of the country, headed by Metropolitan Life Insurance president Richard Shinn. We have set up a long-range study of the city's fiscal problems, and its tax structure, so that—that is, this commission composed of outstanding urban leaders and fiscal experts. We have discontinued the practice which has been in existence for many years of paying for operating expenses by the issuance of bonds through capital, through our capital budget, and not only discontinued the practice, but have begun the shift of these items back to the expense budget at the rate of 50 million a year.

We put in a freeze, almost a total freeze, on all new construction. We have taken every conceivable step possible to satisfy the investing public and the Federal Government that New York City is ready to sacrifice anything in order to get the help necessary to continue rendering vital services to our city.

Nothwithstanding all these actions, and even after we were praised highly by the—and for the first time—by the New York City financial community for taking these steps, unfortunately the market is still closed to us. Ours is a cash-flow problem. Ours is not a budgetary problem. We have some $12 billion in revenue that we are expecting to get in during the course of this coming year, but in order to live between the period we get the revenue, we must borrow, just like any business does, on its accounts receivable and other sources when they don't get the flow of cash needed.

It is interesting to note that even if the city were to default and not pay its debts between now and June 30 of 1976, we would, in the period after November 30, up to which, as I indicated earlier, we have the financing, from December to March, in those 4 months we would have a short-fall of a billion dollars or more to pay for our ordinary operating expenses. In the following 3 months, we come out with a surplus, because our cash comes in at times when we—at least, we don't get it as frequently as we should or as near the time of our expenditures.

The Federal Government apparently is the only source that we can go to now. It has been recognized that the State has done all it can. The city has done and is committed to do, in the months ahead, more of what we have done, and if the Federal Government does not help us, I think we will find the problem afterwards which you will have to help us with much more serious, just as, for example, in the case of Penn-Central, where there was a reticency to help them and nothing was done, and then they went into bankruptcy and then the Federal Government had to step in with both feet and now is really, as all of you know, to a very great extent, is in financially.

So that in answer to the observation which has been made frequently, well, take care of your own problems, I think we tried to do that as intensively as is possible. With all deference to my colleagues in the U.S. Conference of Mayors, many of whom I know have a similar problem or are bordering near that, I don't think any city in this country has ever done the things in a matter of almost 2 or 3 months which normally would be done over a period of years in terms of the reductions and cuts in services in order to bring our city back to a sound financial basis.

And so I earnestly urge the Congress, and we are going to obviously do the same with the President, to help now, when help will really be of benefit to the city and the country. Help later will only create a bigger problem for the Federal Government.

There are several proposals which we—a couple of proposals, rather—which we plan to advance, neither of which costs the Federal Government anything. One might be—and I might say these are not limited; there may be many other approaches, and I know there are bills in Congress which many of the Senators here have sponsored—two additional things which we are presenting and hope to present to the President today would be a loan guarantee and amendment of the Lockheed bill, but, and this is significant, because I think the—much of the opposition of the Treasury Department to any help by the Federal Government is that the instrument which would come out if it were a municipality, tax-exempt instrument, guaranteed by the Government would be better, perhaps more attractive then the Federal Government's own Treasury bills, and more attractive than any of the municipal instruments throughout the country.

And so in fairness to all the other municipalities, what we are proposing, among other things, is the setting up of a loan guarantee program where the bond or security which is issued is taxable, and that would obviously limit the number of communities who would be inclined to come to the Federal Government help.

And we are also pointing up the fact that included in any kind of legislation of that nature, which I think is to a great degree included in the Lockheed legislation—I shouldn't call it that, the legislation which enabled Lockheed to get its guarantee—would be strict criteria with respect to meeting standards which would be set forth in the legislation, again for the purpose of limiting the number of cities who would come for that kind of aid.

Secretary Simon and others say, well, if we do it for New York, that is going to open the whole question for the rest of the country. That isn't so, because with the criteria of that nature, and among them would have to be the fact that the spigot has been turned off, that it is impossible to borrow, and I could hardly see municipalities rushing to come to the Federal Government if they don't need it, so that they can be subject to all these restrictive measures. I think if such a program were adopted, it would be on a very limited basis and only where the need was clearly justified.

A second approach has been the—which is being suggested—is a 1975 version of the RFC, wherein an outright loan would be made, but which again, would not be in competition with Federal securities, with municipalities, and at the same time, cure the conditions where the situation was serious.

And so I sincerely hope that—I know there is a great deal of sympathy for the situation in New York among many Members of Congress. I sincerely hope Congress will enact some kind of legislation that would help the city and help any other community which is, or finds itself, in the same position as our city does.

Chairman HUMPHREY. Thank you, Mayor Beame.

Mayor Landrieu, do you want to proceed?

Mayor LANDRIEU. Yes, Mr. Chairman.

Chairman HUMPHREY. May I say we do ha[illegible] time constraints. It was very important to hear the mayor of New York lay out the problems and the solutions that he has outlined. If we can move along, and then I am going to ask the members of the committee if we will restrict ourselves to a 5-minute inquiry, each of us.

Mayor LANDRIEU. All right. Mr. Chairman, I would like each of the mayors to give the committee a very brief expression and then we will hold ourselves for questions, and I suggest we start to my left, with Mayor Dick Hatcher and go right down the front table.

STATEMENT OF HON. RICHARD G. HATCHER, MAYOR, CITY OF GARY, IND.

Mayor HATCHER. Thank you very much, Mr. Chairman.

I would like to express my appreciation to the chairman and to the members of the committee for hearing us this morning and my remarks will be extremely brief.

I think Mayor Beame has outlined the essence of the problem and at least some general suggestion toward the solution. I do want to make the point, first of all, that we do not come here as persons who are guilty of reckless degree of spending in our own communities. In Gary, for example, we are going into our third year under a State-imposed tax moratorium. We have not been able to increase our revenues from property taxes for the last 3 years because of the State law.

We have taken the position that positions have to be cut out of the budget because we are confronted with certain increases in expenditures that cannot be avoided. Our utility expense has increased by about 26 percent in the last year. The cost of gasoline has increased by about 35 percent in the last year. And each time those increases take place, it means that we have to reduce our personnel or services to the people of our community.

We have raised our property tax level to a point that it literally is driving people out of the city instead of bringing people into the city. So, we come here not as individuals who have ignored the realities of the fiscal crisis that cities are confronted with.

At the same time, I think it is important to reiterate the point that Mayor Beame made, which is simply that New York sends about $15 billion to the Federal Government and gets only about $2 billion back. That is, to some degree, true of almost all of our cities. We send more than we get back.

We have been faced with an increase in the cost of selling bonds in our city over the last year, as I suppose every city in the country has. For example, the last bond issue that our sanitary district sold, we were able to sell it for about 5.5 percent. This year, we just made a $4.5 million issue and the cost of that was 7.75 percent. Our short-term obligations have increased also. Last year we were able to sell short-term notes for about 5.5 percent. This year, those same notes cost us 6⅝ percent.

So, I think the reality is that we have already begun to feel the impact of New York's situation, and that, of course, is going to increase.

I don't think that it is necessary to overly emphasize our concerns here before the members of this committee, because I believe this committee is as concerned as we are. It is our hope that with your support and your help, we will be able to persuade the President that we cannot, under any circumstances, afford to allow a great city like New York to default.

Chairman HUMPHREY. Thank you very much.

Mayor Maier.

Mayor MAIER. Thank you, Mr. Chairman, at this time, I would like to yield, by your leave, to the distinguished mayor of Detroit.

Chairman HUMPHREY. Mayor Coleman Young, mayor of the city of Detroit, if you please.

STATEMENT OF HON. COLEMAN YOUNG, MAYOR, CITY OF DETROIT, MICH.

Mayor YOUNG. Thank you very much, Mayor Maier and members of the committee. I shall attempt to be very brief.

First of all, I believe that all of the mayors here look upon New York's problem as symptomatic of a national crisis in American cities. Indeed, a national urban crisis that has been too long overlooked here in Washington. The impact of New York's crises obviously spreads far beyond the borders of that city and that State, and has a very telling effect on all other cities.

I can cite my own city, for instance, and has been pointed out, it does not matter to the bond market whether the cities have taken steps in order to correct their situation or whether they have not.

In Detroit, for instance, we have within the last 18 months reduced the number of our public employees from 25,000 to 20,000. That is a 20-percent cut in services to our people. We have taken every kind of measure that we can and yet, as we approached the bond market over the last year, we found that the imminence of the crisis in New York City has affected our ability to sell our bonds. Never, prior to 1974, did Detroit pay in excess of 6 percent on a general obligation bond. As we approached the market last year, already with rumblings of the New York crisis, we found we were unable to float bonds within the 8-percent limitation, but our State legislature proposes bonds, withdraws those bonds, goes back to Lansing, our State capital, gets the ceiling raised to 10 percent, again approaches the bond market on a $30 million issue where we pay 9.8.

Chairman HUMPHREY. On tax-exempt bonds?

Mayor YOUNG. On tax-exempt bonds, which we feel to be extortionist. We needed another $20 million on the same project. We knew Big Mac was coming and so we went in advance of need to get an additional $20 million, which certainly is prudent, but it was desperation. We paid 9.9—1 point—one-tenth of 1 percent short of our limit. We need more money and will need it within the next 6 months. We cannot legally pay the 11 and 11½ percent that is in demand now.

Chairman HUMPHREY. Let me get that figure correct. Did you say 11 percent?

Mayor YOUNG. That is the going rate, Mr. Chairman, on Wall Street. Mayor Beame can testify to that point.

So the point that I am making is this is a threat to the stability, to the existence of every city, every county, indeed, every State in this Nation.

When we talk about the dangers of double-digit inflation, I submit to you that we arrived already at double-digit interest rates that face the municipalities of this country, and which could well break the backs of every city and, indeed, the Nation.

I think that the impact is even larger than that. I too, am not an economist. I know what is happening in Detroit. I know that New York is the financial capital of the world. I don't now what will happen to the banks across this Nation and across the world if New York should default. What should happen in a domino theory, an economic domino theory to the stability of our economy? I think that obviously we need to meet what is a national urban crisis and we need to meet it on the same basis that the Federal Government recognized in the 1930's, that the national crisis in our farms threatened the existence of our Nation. We need to mobilize fully the full resources of our Federal Government in order to save our cities, because if our cities go down, in my opinion, our Nation will go down.

While we talk about New York City, and the problems of other cities and what the administration is doing, I would just like to know what is happening here in Congress to the anti-depression public works bill, which now languishes in conference, which would have a meaningful impact on the needs of every mayor representing every city here. So, I think while we talk about what the administration isn't doing, Mr. Chairman, we should also talk about what is Congress going to do about anti-recession, about public works. We need that money. New York needs that money.

I think in closing, we stand on the brink of a national and international financial catastroph. Now is the time for action and leadership by the Congress, as well as the administration.

Chairman HUMPHREY. Thank you very much, Mayor Young.

May we have your next witness, Henry. Mayor Gibson of Newark.

STATEMENT OF HON. KENNETH A. GIBSON, MAYOR, CITY OF NEWARK, N.J.

Mayor GIBSON. Thank you very much, Mr. Chairman.

Mayor Young has certainly pointed out the fact that we are now presently being affected by the interest rates that are a result of the New York City situation. Newark, which is a neighbor of New York City, has rejected recently two bids for bonds. I must point out that those were single bids. Now, the practice is we have the single bids in the municipal bond markets, tax-free again. We were running in the past between 8 and 8½ percent. We are now rejecting bids at 9¼ and 9.6 percent. I am now laying off policemen, sanitation people, and other people because we have to reduce services because the continued increase in the rates is affecting our ability to maintain the normal operating budget for the city.

I have said over and over again before this committee and others that wherever American cities are going, Newark will get there first. That is not true. New York has arrived first. And I think that we have a decision to make as to whether or not we are going to allow this kind of thing to happen to the most important city in this country.

We have taken care of, through whatever legislation was necessary, aircraft manufacturers, railroad companies, other nations, other nations in Southeast Asia, in Europe, in the Middle East, and Central and South America. The real question is whether or not we are going to turn our backs on the largest city in this country.

Chairman HUMPHREY. Thank you very much, Mayor Gibson. I think I should tell you very quickly I am chairman of the Foreign Assistance Subcommittee and we may want to do something there. [Laughter.]

Mayor Alioto, if you please.

STATEMENT OF HON. JOSEPH L. ALIOTO, MAYOR, CITY OF SAN FRANCISCO, CALIF.

Mayor ALIOTO. Thank you, Mr. Chairman; I would like to present as concisely as I know how a very specialized situation. Within the past week, our advisory committee on intergovernmental relations has issued a report on 30 American cities, and it said that there were five of these cities—San Francisco was one of them—with Triple-A ratings, whose fiscal stability there was no question about. As a matter of fact, within the past year, we have finished our year with a $33 million surplus and on top of that, as you know, we just finished a $1½ billion project on public transportation.

The question is what are we doing here? I am here because I and my bankers are convinced that that situation in San Francisco, enjoying the lowest interest rates in the country on its bonds will not survive the bankruptcy of New York, bankruptcy in the technical sense of not being able to meet obligations as they mature.

Our bankers are convinced of that, and I am convinced of that, and that is why we are here.

We are here, too, because New York didn't create its own crisis. New York didn't create the thing we call the urban crisis and New York was not the cause of the ravaging inflation that victimizes New York as much as it victimizes everybody else. They didn't really cause it, as you know, although there are people in this country out of a certain prejudice who talk as though New Yorkers are solely responsible for the financial condition of the city, and I think you can make out a better case that Federal policies over the last 30 years are more responsible for that financial position than New York's responsibility.

Finally, we are not here rattling a tin cup. Nobody is doing that. These cities support the Federal Government. Seventy-three percent of all your revenues come out of these big cities. And if it is important to save Lockheed, and certainly it is important, if it is important to save Penn-Central, then I think it is much more important to save New York.

We can survive throughout the world the image of having lost Lockheed, Lockheed having gone into bankruptcy, just as Rolls Royce went into bankruptcy. We can survive that and we can survive the Penn-Central, but the world looks on New York as the financial capital of the United States and they will not understand how the financial capital of the United States was permitted to go bankrupt, and that is bound to affect San Francisco and is bound to affect every city represented by the mayors sitting here at this table, and that is the point I would like to make.

Chairman HUMPHREY. Thank you very much, Mayor Alioto. By the way, we thank you for your earlier testimony along with Mayor Young and others that have testified here.

Mayor Alexander of Syracuse.

STATEMENT OF HON. LEE ALEXANDER, MAYOR, CITY OF SYRACUSE, N.Y.

Mayor ALEXANDER. Mr. Chairman, I will not try to make a defense of New York, because I think Mayor Beame has done that admirably, nor will I ask for preference for New York City, because I don't think New York City is entitled to preference over any other city in the United States, but I do think what has afflicted New York will soon afflict other cities in the United States, and possibly my own. It is just a question of time.

As Senator Ribicoff has pointed out, it seems totally unfair that New York City should carry the national burden of putting on welfare immigrants that come to this country via New York. I would like to extrapolate that and show how it affects Syracuse, because certain experts have said what happens to New York will not affect other cities substantially in the United States, and I disagree with that.

Under the formula, those people are on welfare in New York, and the budget for that is nearly a billion dollars, as I understand it. Fifty percent is provided by the Federal Government, 25 percent by New York City and 25 percent by the people of New York State. That means the people of Syracuse, the people of Buffalo, the people of Rochester and Binghamton, all substantial cities, must provide for the care of these people. That is truly a national problem, as Senator Ribicoff has pointed out.

We find ourselves in a vicious cycle because, as Mayor Alioto has said, when recession hits the city, it hits hard first and leaves last. Since 1969, some 400,000 jobs have been lost in the New York City area, and these jobs did not go to the metropolitan area. They simply vanished. And as a result, the city's revenues fall off, and this is true of all of the cities in America. When revenues fall off, the quality of education that we deliver, the quality of care that we provide for the elderly, that, too, falls off. The quality of police protection falls off. And as a result, more people leave the cities. And it is a vicious cycle that we find ourselves caught in.

Buffalo attempted to float $35 million in sewer bonds recently. No one bid for those sewer bonds. The Big Mac Corp. had an offering, 11 percent interest. Buyers did not rush to grab those securities. And I am concerned, because while all this is going on, Mr. Simon is telling the President that the New York City situation really will have no impact on other municipalities or on this Nation, and yet the New York City bonds dominate the short-term market. Forty percent of all short-term obligations are New York City.

In New York State, New York City has $13½ billion in long-term bonds. New York State has a like amount, $13.5 billion. All other local units of government in New York State compose $10 billion in bonds. So we have got $37 billion in bonds; $13.5 billion just New York City alone.

The leading rating agency has said that if New York State makes any further efforts to help New York City, then New York State's own credit rating will be severely and seriously damaged.

My city operates on a budget of $105 million. One-third of that revenue comes from New York State. What happens to New York

City affects the people in my city and the people in my State and the Nation.

I am not a fiscal expert. When Mr. Simon speaks, he speaks with authority because he does know about municipal bonds, but I question his judgment in this particular instance, and I have collected the reports of three of the leading experts on municipal bonds, men that Mr. Simon would recognize as the leading experts in this country. Mudge, Rose, Guthrie, the leading law firm in New York, which probably handles the largest share of municipal bonds in this country, reported this to me, and I would like to make this a part of your record. Just one sentence.

"In conclusion, it is our opinion that an actual default by New York City would be disastrous to the market for municipal and public securities over the entire country and that it would be a substantial period of time before the adverse effects of such a default could be eliminated."

Chairman HUMPHREY. Would you leave that with us, because I am going to have Mr. Simon here and I am going to quiz him about it.

Mayor ALEXANDER. I'll be glad to. Yes, sir.

Chase Manhattan Bank, with which Vice President Rockefeller has some familiarity, reports this to me through one of its regional presidents, who also advised me that this is in agreement with the policy of the Chase Manhattan Bank of New York itself. He said, in his remarks to me, that—

"It can be safely assumed that any failure by either New York State or city to meet maturing obligations will further erode the national market for municipal securities and cause vital government programs at the State, county, and local level to go unfunded throughout the Nation."

Unlike New York, my city does not bond except for capital projects. We build our schools by bonding. We build our firehouses by bonding. Our major projects are funded by bonding. The impact on us would be very serious.

For example, a $10 million bond in my city, and I just recently paid a little under 6 percent for some $10 million, just a month ago, would it increase but 1 percent over a 10-year period, it would cost my city, just 200,000 people, an additional half million dollars. We can't afford that.

City Bank, also a large and well respected institution, and very well respected by Mr. Simon as well, I am sure, essentially says the same thing, that help is necessary for New York City at this time at the Federal level.

I am sure that there is a good chance New York can save itself and I am sure that New York—there are some who say New York City's default would not hurt other cities, and I respect the opinions of other people, as we must, but I just ask even the most adamant foes of help to New York City can we possibly risk the urban collapse and the urban damage that even they admit exists when there are avenues open to to the Federal Government to move in and help, not just New York City, but every city that is waiting in line behind New York City at no cost to the Federal Government?

Thank you.

Chairman HUMPHREY. Thank you very much, Mayor Alexander.

We will include the material you have submitted in the hearing record.

[The material referred to follows:]

MUDGE, ROSE, GUTHRIE & ALEXANDER,
New York, N.Y., September 23, 1975.

Hon. LEE ALEXANDER,
Mayor of the City of Syracuse,
Syracuse, N.Y.

DEAR MR. ALEXANDER: You have requested my opinion, as Bond Counsel for the City, as to the effect of default on bonds or other obligations of the City of New York would have on the bond market for other cities and political subdivisions.

I think such a default by New York City would seriously depress the municipal bond market in the entire country. New York City has always been considered the financial capitol of the United States and its bonds and other obligations in the past have been very highly regarded in the municipal bond market. According to my recollection, bonds of New York City are the only municipal bonds which have been listed on the New York Stock Exchange. Consequently, I think a default by New York City would be the most serious default which could possibly happen to the municipal bond market, and would adversely affect the municipal bond market in the entire country, and would be particularly damaging to the State of New York, and the municipalities and other political subdivisions in New York State, and cities in other states which have problems somewhat similar to those in New York City.

I think it is impossible for a default by the largest City in the country not to create doubts in the minds of investors as to the stability of other municipal bonds.

The adverse effect of such a default has already been amply demonstrated by the mere possibility of default which has been discussed in the newspapers and other media. The Buffalo Sewer Authority failed to obtain a bid at public sale, and notes recently issued by the State of New York carried a record high interest rate of interest. I think it is safe to state that the entire municipal market has already been deeply depressed by the possibility of default by New York City.

The situation is somewhat comparable to the depressed municipal bond market in the great recession of the 1930's. The municipal bond market was so depressed in the early years of 1930 that many cities and political subdivisions could not market their bonds. The situation became so desperate that the Federal Government, through one of its agencies, purchased the bonds or other obligations of many cities and other political subdivisions in the country, including the Buffalo Sewer Authority and the Pennsylvania Turnpike. This action by the Federal Government was the major factor in the stabilization of the municipal market so that municipal bonds and other obligations could again be sold without assistance from the Federal Government. It is further my recollection from published reports that there was no loss to the Federal Government after the resale of the bonds and other obligations which it had purchased in the municipal market after its stabilization.

In conclusion, it is my opinion that an actual default by New York City would be disastrous to the market for municipal and public securities over the entire country and that it would be a substantial period of time before the adverse effects of such a default could be eliminated.

If I can be of any further assistance in the matter, please advise me.

Sincerely yours,

JOHN T. TRIMBLE.

CHASE MANHATTAN BANK,
Syracuse, N.Y., September 22, 1975.

Hon. LEE ALEXANDER,
Mayor of the City of Syracuse,
City Hall, Syracuse, N.Y.

DEAR MAYOR ALEXANDER: I know that you, as a Chief Executive of one of New York's major cities, are vitally concerned about the financial problems of New York City and the potential impact of these problems on the well-being of our own City and that of New York State. I thought it might be useful for you to have the views of our Corporation on this issue, as we are deeply involved with the financing of New York City, and through our statewide banking activities with the financial management of Syracuse and other major cities in the State.

The problems of New York City have been well documented, as have been the major organizational and financing steps taken to deal with them. The management of our Corporation feels that the steps which have been taken and the structure which has been put into place will, over time, restore New York City's financial integrity and viability. Time is the critical ingredient, however. Investor confidence in New York City will not be restored in a few months. Investor confidence in New York State will be seriously impaired if the State underwrites City credit for the 2–3 years which may be needed to turn the corner. What we believe to be the only viable alternative is a *temporary* substitution of Federal credit for the city's, in order to insure the marketability of City debt until investor confidence is restored by a year or two of demonstrated performance in meeting the targets which have been set forth.

What are the implications for New York State, Syracuse, and other major cities if sufficient time to demonstrate improvement is not made available to New York City in the form of limited and temporary Federal support? The question goes far beyond the financial viability of New York Communities. Throughout the country the capital market for municipal securities is in turmoil. Rates have soared and the willingness of investors to purchase the obligations of *any* municipal government have diminished considerably. Rating agencies have warned New York State that any further State support to New York City will jeopardize the State's credit rating. It can be safely assumed that any failure by either New York State or City to meet maturing obligations will further erode the national market for municipal securities and cause vital government programs at the state, county, and local level to go unfunded throughout the nation. Here in Syracuse I am certain that even though local debt issues might remain marketable because of the sound financial history of the City, the rates these issues would command might well cause their postponement and thus the abandonment of some vital programs and services.

Thus we feel from both a local and a national perspective that temporary Federal support for New York City is of the highest priority. Some critics appropriately question whether this sort of solution would lead to open-ended Federal underwriting of many cities. This is a valid concern, but we believe that such an unfortunate result can be avoided. New York City has taken drastic steps and will take more to restore financial viability. Federal assistance can be tied to the achievement of savings resulting from these steps so that improvement will be assured. In short, sufficient controls and checkpoints could be installed to insure that New York City's Administration would be motivated to seek an early end to Federal support, and other cities, by observation of these mechanisms in action, would be motivated to do everything in their power to avoid Federal involvement in their own finances.

I'm pleased to have this opportunity to share our viewpoint with you. While our mutual priorities involve principally the Syracuse community and it's economy, we are inevitably involved in the affairs of the nation's economy and financial markets. As a concerned corporate citizen, Chase speaks out on issues of importance. We may not always be popular in doing so, but we believe our positions to be well formulated, and can therefore make a positive contribution to effective public debate.

I would welcome your questions or comments.

Sincerely,

DENNIS C. LONGWELL.

NEW YORK CITY MONEY MARKET LETTER, SEPTEMBER 16, 1975

FOREWORD

In the early morning hours of September 9, 1975, New York City's Governor Hugh Carey, signed into law a bill that would facilitate a $2.3 billion transfusion to New York City over the next three months, while shifting the fiscal governance of the City from the Mayor to an Emergency Financial Control Board which would have State appointees in the majority. In creating this new fiscal situation, the Governor and the State Legislature assumed a very weighty task, which required that they act with a sense of responsibility on a bipartisan basis. Their courage in coming to grips with the problem is exemplary, particularly since they are the first to admit that no one knows with certainty where the road that they are taking will ultimately lead. What is known, however, is that the alternatives to the forthright action taken, on both the financial and the control fronts, would have been default for New York City's government, near chaos for its people, and almost unsurmountable financial difficulties for New York State itself as well as various other parts of the country.

The steps taken will assure that these undesirable effects do not immediately occur. They do not assure that we have permanently escaped default and financial chaos. However, the valuable time bought should enable a demonstration of the ability of New York City to be governed in such a way so it lives within its financial means, thus re-opening the door to investors, whose confidence is so vital to the City's sustained financial well-being.

This Letter is being offered by Citibank in the hope that it will lead to a better understanding of New York City's finances, indicating where we are now, where we have been in the past, and options for the future.

EDWARD L. PALMER,
Chairman, Executive Committee.

A NEW NEW YORK CITY?

New York City is the nation's first City in a multitude of ways. Not only does it have a population and business base more than twice as high as its nearest competitor, but it tends to be among the first in social and cultural change.

Thus, New York City's fiscal plight has been of major interest around the country for some months now, not only because of the absolute size of the City budget, but also because of apprehension in various other large cities that, if they are not fiscally vigilant, the same fate could befall them. There is also a strong undercurrent of feeling that any default on the part of New York City would send sever shock waves throughout the entire market for State and Municipal securities.

The prospects for default were staved off—at least for three months—early on September 9 when the New York State Legislature passed, and Governor Hugh Carey signed, a bill which would facilitate New York City's borrowing $2.3 billion, while at the same time putting the fiscal affairs of the City in the hands of an Emergency Financial Control Board, which would have a majority of State appointees.

THE 3-MONTH FINANCING

The total aid package in the Plan is in excess of $2.3 billion. However, as shown in the table, while the legislature can allot much of the funds, in the form of State loans and pension fund investments, some of it is required from the private sector. It should also be noted that the real estate tax prepayment offers particularly temporary relief, inasmuch as it prepays monies that would be coming into the City in late October anyhow.

	Millions
State of New York	$750
of which—	
MAC notes (subordinated)	(250)
MAC bonds	(250)
City notes [1]	(250)
City/State pension funds	725
Pension fund rollover	30(?)
State insurance fund	100
New York City sinking fund	180
Real estate tax prepayment	150
Bank rollover	156
Bank/business private placement	250
Total	[2] $2, 300

[1] Secured by anticipated State aid or assignments of Mitchell-Lama mortgages.
[2] $2,300-plus.

Nevertheless, the size and scope of the aid package is remarkable and represents a significant contribution to easing the immediate crisis.

It should be emphasized that most of the assistance involves purchases of securities of MAC (the Municipal Assistance Corporation). Therefore, the legislation provides for the MAC debt authorization to be enlarged from its present $3 billion limit to $5 billion. Simultaneously, State per capita aid will be available for MAC debt service, after subtracting present and proposed debt service requirements for

City University Construction Fund and Housing Development Corporation. The legislation explicitly provides for $80 MM of State per capita aid for the present. Subsequent allocations can presumably be made in the future.

Also the maximum maturity on MAC bonds has been extended from 15 years to 20 years.

NEW CONTROLS OVER THE CITY'S FISCAL POLICIES

The legislation mandates that there be a Financial Plan for New York City from September 1975 through June 30, 1978, which reaches the following objectives:

(a) For fiscal 1978, a City budget balanced according to strict accounting principles. Substantial progress toward that goal must be demonstrated in fiscal 1976 and fiscal 1977. Progress towards elimination of expense items in capital budget must also be demonstrated. City short-term debt must be reduced during the period by at least $800MM.

(b) The stage should be set for reducing City short-term debt by an *additional* $2.8 billion by fiscal 1985.

The first phase of the Plan calls for monthly revenue estimates, which are to be prepared immediately by the City. Based on these estimates, the City must prepare the Financial Plan for adoption by October. Both the revenue estimates and the Plan itself must be approved by the Emergency Financial Control Board, consisting of the Governor, the Mayor, State Comptroller, City Comptroller, and three appointees of the Governor: William Ellinghaus, of N.Y. Telephone; Albert Casey of American Airlines and David Margolis of Colt Industries.

The Board is required to disapprove the Plan if it does not achieve the objectives set forth above, or if it does not properly satisfy all the City debt serivce requirements, or if the City's operations can not be conducted within the cash resources available. In disapproving the Plan, the Board is empowered to direct the reduction of aggregate expenditures in any period to conform to revenue estimates, or to direct any necessary increases for debt service or other required programs.

Decisions about expenditures other than debt service, remain the responsibility of the City. However, if City officials should fail, within the specified time, to apportion the required cuts, the Board is authorized to take matters into its own hands.

As part of the Plan, it must be demonstrated that projected employment levels, collective bargaining agreements, capital construction and other costs be consistent with the revenue increases, and that adequate reserves will be maintained to guard against shortfalls in revenues or over-runs of expenses.

Changes of revenue estimates can be made only by the Board, and the City would be required to make matching expenditure reductions. If it did not do so, the Board would.

In addition to the above restrictions, expenditures for all areas (other than debt service, pensions, & welfare) may not rise by more than 2% annually, and only then if there are sufficient revenues.

Powers of the City and the Board are applicable not only to Mayoral agencies, but also to "independent" agencies such as, Hospitals, Education, and Higher Education.

The Board will direct a special Deputy State Comptroller to review City operations, to audit compliance, to examine the efficiency of City Departments. and do other fiscally pertinent work. The Board has been given the right of access to all City fiscal data.

The Board is also empowered to review and approve major City contracts (including collective bargaining) and is required to assure the compliance of such contract with the overall Financial Plan before the contract could be put into effect.

The Board also has to grant prior approval, together with MAC, to all City borrowing.

The Board is authorized to issue orders binding on the City, in connection with the above areas. The Board would have even broader powers following any City default.[1]

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[1] Under the act, in the event of default, the Control Board would work with the City in submitting a repayment plan to the courts, while all creditor claims would be stayed for at least 90 days.

City revenues will be deposited daily into special Board accounts. These may be disbursed only with approval of the Board, once it has determined that the disbursals are consistent with the Plan.

The Board will be required to maintain a special "debt service repayment account" of funds sufficient to meet debt service requirements for each quarter.

If there are insufficient funds to meet all demands, debt service and other mandatory payments would be paid first, and the balance allocated according to priorities set by the City. If the City has no specific priorities the Board can withhold payments for such purposes entirely, or can pay them on a pro-rata basis.

The legislation also stipulates that the wage freeze, in effect to September 1976, may be continued up to June, 1978 by the Board if necessary.

City officials violating their responsibilities under this legislation will be subject to criminal prosecution, specifically for permitting expenditures in excess of the required limits, or for knowingly presenting inaccurate financial information (including projections or estimates). They are also subject to removal from office by the Governor for failing to comply or for failing to have subordinates comply with the requirements.

LOOKING BACKWARDS

New York City's fiscal problems did not happen overnight. They had been brewing for over a decade. What has made this year unique is that the accumulation of the results of the extended period of fiscal mismanagement became so overwhelming that they could no longer be ignored.

Following a sharp decline in investor confidence late last year, the City reached the point early in 1975 where its bonds and notes could not be sold at any price. Indeed, most of the last issue marketed—a $375 million three-month issue sold last March in anticipation of specific state revenues due in June—remained in the hands of the underwriters for an inordinately long time despite an attractive interest rate.

During the Spring, with the financial markets closed to New York City, the municipal government was kept afloat only by prepayments from the State of some $800 million of aid normally due in fiscal year beginning July 1, 1975. Meanwhile, last June, the state created Big M.A.C.—or more formally the Municipal Assistance Corporation for the City of New York—to serve as an interim borrowing vehicle for the City.

Big MAC was authorized to borrow up to $3 billion in the market, and make these funds available to New York City, thus covering the City's cash deficit for the July-September period. MAC was set up as an agency of New York State, with the 4% City sales tax being converted to a state levy, and transmitted to MAC for debt service each year, with only the remainder reverting to the City. Beginning in April, 1976 the stock transfer tax, if necessary, could be similarly utilized. Above and beyond these, the State assumed a "moral obligation" to make up any shortfall in annual debt service requirements.

Despite these safeguards, it soon became obvious that there was virtually no interest in buying MAC securities outside of New York City as long as the City's fiscal situation continued on a "business as usual" basis. MAC's first $1 billion issue could be sold only because the commercial banks, savings banks, and some life insurance companies pledged to take $650MM. Even the remainder was not immediately sold out despite interest rates running to 9.5%. When the issue was released from syndicate restrictions on July 21, prices dropped by up to one-eighth of face value, and effective rates rose to between 10% and 11%.

This situation jolted both City Hall and the MAC board itself into action. Proposals which had been bruited about in the past, but had been roundly rejected as unthinkable, suddenly were revived. As announced on July 31, these included wage and hiring freezes on City employees, higher subway and bus fares, and economies at the City University.

On August 6, the Mayor announced the creation of a Management Advisory Board, under the leadership of Richard R. Shinn, President of Metropolitan Life Insurance Company and widely respected in the business community. Other members of the Board, as announced the following week, include MAC Chairman William Ellinghaus, banker John McGillicuddy, and other respected leaders in commerce, industry and labor. Detailed studies and recommendations on management and productivity in city government will be done for the board by a task force under the co-directorship of Planning Commission Chairman John Zuccotti and MAC Executive Director Herbert Elish.

It is still too early to evaluate how well those steps, culminating in the Albany "rescue/takeover" program, will work out. Acute challenges, such as the teachers' strike, will serve as tests of the direction the City will take. In general, progress will have to be closely monitored in the weeks, months, and years ahead.

THE CREDIBILITY OF THE 1975–76 CITY BUDGET

As of the beginning of September, the City's expense budget for 1975–76 would probably have been about $12.3 billion. However, under the new rules of the game, it is not unlikely that expenditures will have to be pared down to about $12.1–$12.2 billion.

This will be some $200–$300 million higher than the "crisis level" budget accompanying the Mayor's budget message of May 29th. It represents a rise of 9% (about $1 billion) from the 1974–1975 expense budget as originally submitted in May 1974. However, due primarily to higher-than-expected expenditures, last year's budget was almost $1 billion higher than projected-totalling roughly $12 billion. In other words, if the City is able to hold to its new budget for this fiscal year, it will represent virtually no growth from the previous year—which would be quite amazing feat for any city, particularly New York.

New York City's budgetary growth in the decade from mid-1965 to mid-1975 was essentially the same as urban America's as a whole—only more so. In the first half of the decade, expenditures rose rapidly (averaging 15% a year in New York City) as all levels of government responded vigorously to the challenge of the cities with numerous new programs and dollars. New York City experienced substantial growth in the number and scope of its programs, as well as in the size and pay levels of its municipal work force. However since the federal and state governments were picking up increasingly large shares of the tab, the expansion appeared to be relatively painless.

Between mid-1970 and mid-1975, however, there were significant shifts on both sides of the budget. Although the rate of growth of New York City's expenditures slowed to an average of 12% annually, state and federal funds were decelerating even more sharply. Meanwhile, the acute inflation of the early Seventies exercised strong upward pressures on municipal wage rates, and the deep economic recession for the past few years has brought about sharp increases in expenditures for welfare, health services, and other poverty-related categories.

It has become progressively evident that the heavy pressures on the expenditure side, in the absence of corresponding increases in federal and state aid, could not be sustained. For some time, New York City, the heaviest taxed of any major city in the nation, has been losing middle- and upper-income residents, as well as businesses and jobs. Since the only way to get a higher tax yield from a shrinking tax base has been to increase tax *rates*, the tax burden on New Yorkers has continued to increase.

It is perhaps small wonder that, faced with these acute fiscal dilemmas, New York City Mayors have cast about for new ways to "stretch" revenues and to stave off the City's payments. Thus, for over a decade now, funds from the capital budget—which should be used exclusively for infrastructure and other long range purposes—have been utilized in the expense budget. Simultaneously, the City's use of short-term borrowed funds, which amounted to only some $500 million in June 1965, and $1.3 billion in June 1970, reached the astronomical figure of $6 billion last March. It was clear that something had to give.

Against this background, the efforts required to hold the City's budget this year at virtually the same level as last year will be nothing short of Herculean. Indeed, since some expenditure areas (particularly in the welfare category, deb service, and pensons) will inevitably go up, a no-growth budget means absolute *declines* in most of the other categories. This clearly indicates that the budget is not realistic *unless* the wage freeze (especially in its modified form) is accompanied by a tough combination of attrition, layoffs, and operations economies in virtually all City departments.

On the City's traditional accounting system, this year's budget would appear to be in balance. However, on August 29, MAC released data which showed that the budget would really have a $726MM deficit this fiscal year, if stricter accounting practices were employed. This refers to reserves for uncollected real estate and other taxes, as well as Federal and State aid overestimates, and the conversion of expenses from a cash to an accrual basis.

65-920—76——3

The figures released by MAC also indicate that the cumulative deficit from prior years should properly be put at $2,582MM. Adding the past and current figures would give a grand total of $3.3 billion.

Reflecting on these figures, MAC urged (and subsequently embodied in legislation) that the City take immediate action to reduce expenditures substantially from projected levels. This means, as shown, some savings in the current fiscal year, and major savings in each of the next two fiscal years so that fiscal 1978 shows a truly balanced budget, or even a slight surplus, as seen in the table.

CUMULATIVE SAVINGS

[In millions of dollars; adjusted for inflation]

	1975-76	1976-77	1977-78
1975-76	152	163	174
1976-77		304	325
1977-78			304
Total	152	467	803
Deficit	-726	-742	-801
Net	-574	-275	2

PROSPECTS FOR MAC AND NEW YORK CITY IN THE FINANCIAL MARKETS

The newly enacted legislation permits MAC to borrow a grand total of $5 billion, up from the $3 billion initially authorized. MAC borrowed $1 billion in July. Of this amount, $650MM was from commercial banks, savings banks, and life insurance companies. The remainder was sold through hundreds of underwriters to investors, primarily based in New York. In August, MAC borrowed an additional $840MM including $350MM more from the New York Clearing House banks (of which about $100 million represents a rollover of maturing City notes held by the banks) at an artificial below-market rate. In addition, public pension funds, and further New York State aid advances, were brought into play, so that the offering to the public amounted to $275MM, and even most of that had been privately placed in advance.

Despite the adverse psychology that has beset MAC since it first went to market, these bonds are considered by knowledgeable people as an attractive investment, enjoying the backing of an identifiable revenue which flows to MAC directly from the State of New York. With debt service requirements expected to be $500MM-530MM annually (subsequent to this year when it will be somewhat less) MAC is backed by the City's entitlement from the New York State-administered sales tax, (which was a shade under $800MM in fiscal 1975 and may be expected to be about $850MM in fiscal 1976), augmented, beginning April 1, 1976 by the stock transfer tax (which throws off an annual yield of close to $200MM) and $800MM in State Aid. Yields on the August tranche, ranging from 10% for bonds due February 1, 1980 to 11% for the 1983 maturity, turned out to be not unattractive to investors, particularly since they are tax exempt.

Some cautions have been raised about MAC, primarily by out-of-state sources. They question the marketability of MAC bonds. They also raise the specter of a law sut by a City bond holder who might argue that the conversion of the City's share of the sales tax from a City to a State tax improperly impaired his protection and should be overturned. A further doubt relates to the possibility of the State legislature's not appropriating sales tax and stock transfer revenues for MAC in future years.

The marketability concern is not improper, and indeed is a major cause for the extremely high rates available on MAC bonds (ranging perhaps 4% higher than comparable tax-exempt issues rated A or A+). As to the law suit, it is of course not possible to give an absolute assurance but the various law firms that have explored this issue are unanimously of the opinion that such a suit would be without merit. Finally, while there is no absolute guarantee that every future State legislature will make the necessary appropriations, it is equally clear that any abrogation in this respect would be virtually impossible inasmuch as it would undoubtedly destroy the State's own credit in the financial markets.

Thus, particularly in the context of a City now subject to tight fiscal discipline,[2] prices on MAC securities may well show a somewhat firming trend over time. Although a regular MAC offering has been postponed for the immediate future, MAC will apparently be going to market in the not too distant future in "popular" denominations (perhaps on the order of $100). Moreover, regular MAC market offerings before the end of 1975 should not be ruled out.

However, if MAC's access to the public market in December/January is more limited than the City's rather substantial cash needs, some additional bolstering may well be necessary. Concurrently with the passage of the State legislative package, there was a significant upsurge of discussion about Federal assistance. While this would be counter-productive if it were viewed as a substitute for the City's maintaining and restoring its own discipline, it may prove to be an appropriate and helpful supplement to New York City's own self-help program, if effected over a limited time frame.

Chairman HUMPHREY. Mayor Landrieu, we welcome Mayor Maier.

STATEMENT OF HON. HENRY W. MAIER, MAYOR, CITY OF MILWAUKEE, WIS.

Mayor MAIER. Mr. President, I would like to say that it is a distinct honor to appear before this distinguished committee, and particularly the distinguished chairman, who for years as presages this kind of brinkmanship and did everything in his power, with acute recognition of the problems.

The subject, as we well know, is default, and the first definition listed for default in Webster's dictionary is failure to act, neglect. You, Mr. Chairman, have certainly been very mindful of that.

The second definition unfortunately is failing to meet financial conditions, and although the interest of today's meeting appears to be centered on the second definition, New York's failure to meet its financial obligations, I think that we ought to be concerned, as you have been for years, with the first definition, and now culminating in the administration's default, the failure to act in the total urban crisis which affects every sector, every segment of these United States, and its further neglect of the most hard-pressed citizens of this country, the overburdened property taxpayers.

I, like the other mayors, find it most difficult to understand why the administration, which moved very quickly to rescue a bank, the Franklin Trust Co., and Lockheed Corp., still hesitates to prevent a financial disaster which will victimize millions of innocent local property taxpayers across the entire Nation.

My city, Mr. Chairman, enjoys a triple-A credit rating. We have installed a system of budget controls and productivity controls which will rival any in private industry, and certainly equals that of the Federal Government. These are controls which have enabled us to increase the number of our employees by only 6 percent in the period of my office, 1960 to date, almost 16 years, compared to an increase of 44.2 percent by the Federal Government.

Yet, Mr. Chairman, if, after taking the most heroic steps, the city of New York and the State of New York have within their powers to take in the next 3 months, they should fail to prevent default, it can have a chilling effect on Milwaukee's property taxpayers. Our interest

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[2] Another sign of this discipline was the swearing-in on September 16, 1975 of Kenneth S. Axelson, who had been serving as Chief Financial Officer of J.C. Penney, as Deputy Mayor for Finance.

rates could soar, our city could deteriorate due to the necessity to defer vitally needed capital improvements on already overburdened property taxpayers, with further increases in spite of the most valiant efforts to prevent them.

Mr. Chairman, I might make a further point. The argument that New York and other cities in this Nation are in the financial bind because of mismanagement on their part just isn't true. Senator Ribicoff put his finger on it when he related it to welfare. Fifty-five and seven-tenths percent of the residents of New York City fall below the Bureau of Labor Standards for deprivation scale, 15 percent in dire poverty. When you relate this and qualify it in the millions it is an unmanageable poverty level and unmanageable deprivation scale. But I can tell you, Mr. Chairman, that all the management expertise contained in the leading corporations of the United States, from General Motors to Lockheed, and their top level staff people and the President of the United States and thousands of top level management experts, had they been managing New York in the last 30 years, they could not have perceptively prevented this financial disaster if they had to operate from the revenue base that was shrunken by the deprivation scale of New York City and deal with the problems of such unmanageable magnitude, the financial policies that benign neglect over the years has created a city like New York, and we are all, Mr. Chairman, in the same trend. Thank you.

Chairman HUMPHREY. Thank you very much, mayor.

Mayor Landrieu, any other witnesses?

Mayor LANDRIEU. Yes, Mr. Chairman. We would like to now hear from Mayor Ralph Perk of Cleveland.

Chairman HUMPHREY. Mayor Perk of Cleveland.

Mayor PERK. Senator Humphrey and members of the committee——

Chairman HUMPHREY. May we have quiet in the room as much as possible so that we can hear.

STATEMENT OF HON. RALPH PERK, MAYOR, CITY OF CLEVELAND, OHIO

Mayor PERK. Thank you. We all recognize that New York City has a severe financial crisis and that we must help to solve the crisis before it has repercussions on cities across the country. However, the solution to New York's problem is complex and before the Federal Government or the mayors recommend any program, I think more hard facts are needed.

In devising any acceptable program, two factors must be paramount:

No. 1, the legislation must apply equally to all cities.

No. 2, it must not encourage or even allow cities to engage in deficit spending for operating purposes.

My staff and I have been working on a public insurance corporation program to guarantee debt service on municipal bonds. We see some pitfalls in this program, but believe they are not insurmountable. We believe that kind of a program would help all the cities.

One thing is certain. Municipal bonds are becoming more difficult to sell and the interest rates are approaching all-time high levels. Any sensible program must be designed to solve these two problems. We must assure that the New York situation does not recur elsewhere and we must seek to encourage or at least maintain capital improvements at the local level. Otherwise we will all be back in Washington next year with essentially the same problem in other cities.

Chairman HUMPHREY. Thank you, Mayor Perk.

Mayor LANDRIEU. Mr. Chairman, I would like to proceed now with Mayor Barcelo of San Juan, and right across the table, and I am sure we will wind up very briefly.

STATEMENT OF HON. CARLOS ROMERO BARCELO, MAYOR, CITY OF SAN JUAN, P.R.

Mayor BARCELO. Mr. Chairman, I appreciate the committee's opportunity to appear before the—my name is Carlos Romero Barcelo—to appear before you to testify on behalf not only of New York, but in behalf of all cities of America.

I am a member of the committee of the U.S. Conference of Mayors and I am also president of the National League of Cities.

I appear here as mayor of San Juan. I was not accepted in Red China.

Chairman HUMPHREY. You are happily accepted here. A better place.

Mayor BARCELO. As a Puerto Rican we have considered New York the largest Puerto Rican city in the world because we have more Puerto Ricans in New York than we have in San Juan, about a million. So that this affects us very closely at home.

I have heard many of the statements that have been made here. We discussed this last night. And there are many that have been well put as far as how it affects the Nation, how it affects New York City. But I would like to add something, how it affects San Juan, how it affects Puerto Rico, how it affects other cities. I don't know what happens when a city goes bankrupt. I don't know what happens when a city cannot meet its financial obligations. We all know what happens when a business, private enterprise, cannot meet its financial obligations. It closes down. But a city cannot close down. But many areas will close down.

The purchases that the city makes in the community will at least dwindle tremendously. That effect upon the economy of New York, New York City, New York State, and the Nation, will be tremendous.

What will happen to those businesses that depend on the city of New York and those other businesses that depend upon those other businesses? Well, I have no doubt that New York's inability to meet its financial obligations will create serious economic hardships in New York City, would increase the number of unemployed, and many, many of the Puerto Ricans now living in New York which have made New York their home will start looking where to go, what to do, and they will turn toward their relatives, their friends.

We now have 25 percent unemployment in Puerto Rico. We are not ready to cope with 10,000 or 15,000 or 20,000 additional unemployed. And whatever is shifted down to San Juan or the other towns in Puerto Rico, we will have to resolve also, also be a problem. And we have heard that to step in and save New York will set a precedent. Can we afford to set a precedent of a bankrupt city, of New York, which represents in the eyes of the world—people think of New York as the capitol of the United States, not in terms of the political capitol, but at least the financial capitol of the United States. How will the rest of the world look upon us after the problems that this Nation has faced if we have helped other nations and we cannot help our own?

Mr. Chairman, I think that it is important that if New York cannot meet its financial obligations, and I think this is—the "if" is also very important—it must be given aid.

In the National League of Cities we have requested that the effective government committee study this problem and come up with some kind of a policy. They have drafted a policy statement and they—the committee has recommended to the National League of Cities and we are recommending to our board of directors that we support any aid for New York City provided that it is shown that the city and the State government have exhausted all legal, constitutional, and fiscal remedies available within their respective authorities. Once that criteria is met, there is no other way out but to help New York if New York needs help. Not to do so would have serious effects as have been stated here by our colleagues, as far as the marketability of our municipal bonds, the interest rates in our municipal bonds, and it would have the other effects which I have mentioned before.

All cities in New York, all communities in New York, will have to—and other outlying States will have to start facing up to the fact that thousands of people, unemployed people, will be coming back to their original communities, to where their relatives live, and those communities will have to pick up.

I think, Mr. Chairman, each and every one of us should consider that should this not be the case in New York, if it were in your home State of Minnesota, if it were St. Paul, what would happen to the rest of the State if it would happen to St. Paul? What would happen in Connecticut if it would happen in New Haven? What would happen in Massachusetts if it happened in Boston?

I think these are the issues that we have to be concerned with and once we set the criteria, that the local—the legal and constitutional and fiscal remedies available to the city and the State government have been exhausted, then the Federal Government must step in.

Thank you, Senator.

Chairman HUMPHREY. Thank you very much, Mayor Barcelo. We appreciate your testimony and it is on behalf also, I understand, of the National League of Cities, is that correct?

Mayor BARCELO. I am the president. We have formulated a policy, but we are submitting the policy statement which I stated and we can submit it for the record.

We are asking our executive board to adopt and approve this policy, permitting a written vote.

Chairman HUMPHREY. Thank you.

[The policy statement follows:]

POLICY STATEMENT ADOPTED BY THE EFFECTIVE GOVERNMENT STEERING COMMITTEE OF THE NATIONAL LEAGUE OF CITIES, SEPTEMBER 19, 1975

The Steering Committee on Effective Government of the National League of Cities supports the City of New York and New York State in their individual and collective efforts to address their current financial emergency. It is imperative that the public be confident that their cities and states, faced with such problems, will exhaust all measures within their control to solve them.

It is the hope of the nation's cities that the plan devised by New York City and New York State will be successful.

Congress and the Administration should be prepared to assist a municipality to obtain needed credit during a financial emergency only if it is apparent that the municipality and its state government have exhausted all constitutional, legal and fiscal remedies available under their respective authorities. Assistance measures which may be appropriate in a financial emergency, should not be made a permanent feature of Federal policy with regard to municipal bond financing.

The federal and state governments should act to lessen the likelihood of other financial emergencies and reduce the stress on municipal budgets by vigorously carrying out a balanced anti-recession campaign. And for the longer term, the Federal and state governments must do their part to eliminate the underlying causes of many of the financial problems of our cities by developing and implementing a national urban policy that protects the nation's investment in its urban resources.

1.304 MUNICIPAL BOND FINANCING

A. Immunity of municipal operations from Federal taxation

The immunity of state and local governments and their agencies in the exercise of their legitimate functions from federal taxation is necessary for the preservation of our constitutionally delineated dual sovereignty form of government. Local self-government would not survive if the federal government could arbitrarily influence local policy by penalizing certain local activities through federal taxation while rewarding other activities through tax exemptions. The immunity of state and local activities from federal taxation must be uniform and cannot be challenged.

The immunity of municipal securities from taxation by the federal governments must be maintained. Any ruling by the federal Treasury denying such exemption should be countermanded by the Congress through authorized judicial review.

In addition, the mandatory reciprocal exemption of interest on Federal debt obligations from state or local taxation requires similar full exemption of interest on all state and local debt obligations from federal taxation.

B. Broadening the market for municipal bonds

The demands for capital improvements at the local government level should not be inhibited but supported by the federal government in the dual partnership required to address the maintaining and rebuilding of the accesses to a better urban life quality. The federal government in its fiscal policy should not tamper with the immunity of local government obligation from federal taxation unless it can guarantee self-determination to local government to act independently on matters of purely local concern.

If alternative financing mechanisms are considered by the Congress, any such mechanisms must offer the same or improved advantages to cities as cities now enjoy through the use of the tax exempt security. Other criteria against which such proposals must be judged include the following:

A. Any new financing mechanism must work within the frame-work of our federal system assuring protection for cities from fiscal or other policy domination by the federal or state governments. It must preserve the ability of cities to act independently on matters of purely local concern.

B. Any financing mechanism should offer cities at least as much financial advantage as cities presently enjoy by virtue of the tax exempt feature of their securities.

C. The working elements of any financing mechanism must be automatic, irrevocable and enforceable in a court of law.

D. The choice of use of any available financing mechanism must be solely at the option of the user. Moreover, new financing mechanisms must not be viewed as a way to reduce, directly or indirectly, the value of or terminate the tax exempt features of municipal securities; we support Congressional enactment of such financing mechanisms only if the proposal fully meets these criteria and only if the right and option of municipalities to issue traditional tax exempt securities is irrevocably preserved.

E. The administration of any financing mechanism must not subject the user to administrative or other delay that would jeopardize the ability of the user to gain maximum financial advantages in financing costs.

Local governments are strongly opposed to the establishment of "Federal Banks" which purport to sell their own securities and purchase local government bonds, whether or not issued pursuant to a federal grant program. In addition, municipal governments oppose federal government guarantees or insurance of tax-exempt or taxable municipal bonds.

The federal government should not submit the local government authority and its bond issuance procedures to the jurisdiction of the private security regulatory bodies and should enact such legislation as will provide for a broadening of the market for local government tax exempt bonds.

A. Further, Congress should permit regulated investment companies to distribute the tax-exempt interest on local bonds to their shareholders without loss of the tax exemption;

B. Congress should assist in the broadening of the market for local government Revenue Bonds by authorization for commercial banks to underwrite Revenue Bonds.

C. Local financial emergencies

Congress and the Administration should be prepared to assist a municipality to obtain needed credit during a financial emergency only if it is apparent that the municipality and its state government have exhausted all constitutional, legal and fiscal remedies available under their respective authorities. Assistance measures which may be appropriate in a financial emergency, should not be made a permanent feature of Federal policy with regard to municipal bond financing.

Chairman HUMPHREY. Now, Mayor Sullivan.

STATEMENT OF HON. GEORGE M. SULLIVAN, MAYOR, CITY OF ANCHORAGE, ALASKA

Mayor SULLIVAN. Mr. Chairman, very briefly I support the statements these other mayors have made. I say New York is not a bareout. The loan guarantee or emergency loan is just some time they need to get back on their feet. I think we have to move hastily to get this done. In November there is going to be trouble in New York City and if the Federal Government comes in after it happens I think it is going to cost a lot more than it will at this time.

Thank you.

Mayor LANDRIEU. Mr. Chairman, we have only two other speakers, Mayor Maltester and Mayor McNichols.

Chairman HUMPHREY. Mayor Jack Maltester, San Leandro.

I think I should note we have mayors from as far away as Anchorage and San Juan and San Leandro, that two of them are basically suburban cities, that are here talking about the impact of New York upon your communities.

Go ahead, Jack.

STATEMENT OF HON. JACK D. MALTESTER, MAYOR, CITY OF SAN LEANDRO, CALIF.

Mayor MALTESTER. Thank you, Mr. Chairman. I think it is true that I probably represent the smallest city here today. We are well under 70,000 people in the San Francisco Bay area.

My testimony is just a little different on this situation. We have been fortunate in our community. We have reduced our tax rate or held it for the last 27 years, probably the lowest tax rate in the State of California.

We have had a downtown renewal project that has not had any Federal funding. It has been done solely through local funding, revenue bonds, and city taxes. We are in the process now of winding up that program. We are getting ready to issue a $7 million revenue bond issue guaranteed, of course, by our own property tax rate.

I am merely here to tell you that in spite of what you may hear, the small cities of this country support the help requested by the city of New York. Those of us who feel that we are real fortunate in the situation in our communities realize that if New York does default on its bond issues, then we and the other cities are going to have to pay more for our form of government. We then in turn may not have the money to do that and where we have stayed away from asking for Federal funding, we may have to come and ask for it. So I guess what I am really saying is that I think most of the smaller cities of this country support what New York is asking and possibly in my community, in a selfish vein, we would rather see New York helped with the restrictions that they have asked for rather than have our city ultimately get in the same condition New York is in.

Thank you.

Chairman HUMPHREY. Mayor McNichols of Denver. Good to see you, Mr. Mayor.

STATEMENT OF HON. WILLIAM H. McNICHOLS, MAYOR, CITY OF DENVER, COLO.

Mayor McNICHOLS. Thank you very much, Mr. Chairman. I won't belabor the point. I concur in what my colleagues have said and would only say, in my opinion, every city in this Nation is like a tenant in the same building and if someone tells you the third floor is going to collapse, you say that doesn't worry me because I am on the second floor. I don't think that kind of thinking can be condoned, and this city of Denver, in 1973, sold in excess of $30 million worth of bonds at under 5 percent. Four point three-quarters percent. In 1974, we marketed $37 million worth of bonds at almost 6 percent. And this year we offered a lesser amount of bonds and the percent after the New York impact had been more or less sent around the country was in excess of 8 percent.

Now, Denver is a long way from the city of New York, but we are in the same financial building.

Thank you, gentlemen.

Mayor LANDRIEU. Mr. Chairman, that concludes our testimony. I might say in a brief concluding statement that the magnitude of the problem of New York City is largely responsible for our presence here. This could be Dry Prong or Tickfaw. The State of Louisiana could easily bail those cities out. Indeed, the city of New Orleans, though poor as we are, could render assistance. But New York itself, with a $12 billion budget, is larger than the State of Louisiana, Mississippi, Alabama, Georgia, and several others put together. And it is inconceivable to me that an institution of that financial magnitude would be left unaided by the only agency in the world that can be of assistance to it at this point, and that is the Federal Government.

Thank you, Mr. Chairman.

Chairman HUMPHREY. Mr. Chairman, Mayor Landrieu, we have Secretary Simon waiting and what I want to do on behalf of the majority on this committee is to take a very few minutes now just to put a few questions to you with as brief and succinct an answer as you can give because I surely would like to be able to complete it if possible within the next 10 minutes.

I will lead off by asking some questions that relate to Mr. Simon's testimony that he was kind enough to make available to the committee, and you can select whoever you wish to make a response or you gentleman here can affirm by voice or nod of head or by dissent as you wish.

The Secretary says as follows:

First, although the challenges and the task are great, New York City, with the assistance of the State, has both the mechanisms and the resources to avoid default.

Mayor LANDRIEU. Suppose I let Mayor Alexander respond to that.

Mayor ALEXANDER. Well, I don't agree with the Secretary because New York State has already passed legislation which has strained the State's reserves and the State is on notice from its agencies that the rates—its bonds—that the State cannot extend itself any further without damaging its own ability to raise money. That seriously affects the other municipalities in the State of New York because they look to New York State for approximately one-third of their revenues.

Chairman HUMPHREY. Would the mayors who agree with Mayor Alexander's statement so indicate by showing their hands. [Show of hands.] Thank you.

Second, if default were to occur, the event would be primarily legal in nature: The political and social infrastructure of the city would remain intact.

Mayor LANDRIEU. Mayor Beame has clearly explained that not only must he borrow money in order not to default on the obligations, but also must be able to go into the market to borrow money for operating purpses, some $1 billion. In the absence of $1 billion in operating funds, which he faces between November—December and March, in my judgment and I think the judgment of every mayor here, it would be catastrophic on the 8 million citizens of New York as well on this Nation as a whole.

Chairman HUMPHREY. Mayor Alexander?

Mayor ALEXANDER. One postscript. I think Mr. Simon should also be asked to explain how it affects the millions of Americans who have bought New York City bonds because only 5 percent of New York City's bonds are held by banks. Millions of Americans have invested for the education of their children in New York City bonds. Are they to be counted in on the picture?

Chairman HUMPHREY. Yes, Mayor Alioto.

Mayor ALIOTO. I would go beyond that. It isn't legal in nature. It is ridiculous to say that bankruptcy is legal in nature and doesn't affect the economic infrastructure. Bankruptcy of a corporation affects that infrastructure and is bound to do it. Bankruptcy on defaulting bonds means that somebody must go to court, get a judgment on those things, presumably enforce that judgment by an actual bankruptcy, and get a lien on the revenues that are coming in. I don't know how you divorce the law on one side and reality on another side when you are talking about bankruptcy. I think that statement is just incomprehensible.

Chairman HUMPHREY. I am going to take just about 2 or 3 more minutes. Anybody else have a comment on this? Mayor Young?

Mayor YOUNG. May I say there seems to be a tendency in the administration to look upon a city as if it was a business. When a business runs out of money, goes bankrupt, it closes down. The city cannot close down. A city must furnish services to its people. You can't lay off all the school teachers. You can't lay off all the police officers. You can't lay off all the sanitation workers. A city literally cannot close down. If the cities of this Nation close down, the Nation closes down, and therefore we cannot look upon bankruptcy in a city as you would a private institution.

It is interesting to note as previously we have rescued private institutions, a la Lockheed, and Penn-Central.

Chairman HUMPHREY. Do I understand the majority of the mayors disagree with the comments of the Secretary, that the situation is essentially legal in nature?

Mayor LANDRIEU. We are unanimous in that.

Mayor BEAME. Of course we are. I must say the only reason I haven't spoken is that the other mayors so eloquently present the situation.

Chairman HUMPHREY. I understand, Mayor Beame.

The third judgment that Secretary Simon makes in his testimony is:

"While a default could adversely affect the capital markets, the effect in my judgment would be tolerable and temporary."

Mayor ALEXANDER. You have the opinions of the leading bond experts in this country before you, Senator. I filed them with you.

Chairman HUMPHREY. Anyone else have a comment?

Mayor BEAME. All I can say is to question what temporary means. Temporary could be a long time because if New York defaulted, it is going to hurt, as was clearly indicated, units throughout the country and before New York could get back into the market would take a long, long time.

Chairman HUMPHREY. Is this the view of the mayors here now that a default would adversely affect capital markets and would have more than just a temporary impact?

Mayor LANDRIEU. Yes, sir. I think we are unanimous in that opinion also.

Chairman HUMPHREY. Mayor Perk?

Mayor PERK. It is the view of the mayors that it would have such repercussions and that is why I devised a serious program which I think is one of the alternatives Congress should be looking at, and I would like to reserve judgment on all these final questions until I hear from Secretary Simon. I understand he is to testify.

Chairman HUMPHREY. That is correct.

The final observation of the Secretary is this:

"A default would cause little, if any, damage to our financial structure: The banking system would remain intact, no bank customers would lose their deposits, and the system would continue to be able to provide credit to all levels of the economy, including consumers."

I might add for the edification of the mayors and more importantly of the Secretary that the Chairman of the Federal Reserve Board doesn't agree with this at all. As a matter of fact, Chairman Burns' letter of reply is inserted in the record at the end of my opening statement, wherein he says that the Board—the Federal Reserve Board, would be—has agreed that funds would be made available on whatever scale is deemed necessary to assure orderly financial environment. The credit thus extended to member banks would supplement normal borrowings at the discount window.

He goes down a little bit later to say that the municipal as well as other markets have long been aware of the New York City problem. Last week, when expectations of a New York City default were widespread, yields on State and local government securities reached on the average a record high.

Now, Mayor Landrieu. How do you wish to assign this question?

Mayor LANDRIEU. Mr. Chairman, last year the city of New Orleans withstood an 80-day transit strike which virtually crippled that city economically. I hesitate to think what would happen in New York City if they experienced a $1 billion shortfall in their operating funds and could not operate their transit systems or their police departments or their fire departments. I think it is a little naive to suggest that the financial infrastructure stays in place while the services of a city come to a grinding hault. That just doesn't happen.

Chairman HUMPHREY. Mayor Alioto?

Mayor ALIOTO. In that, Senator, may I add that the top executives of the Bank of America, pretty good-sized bank, their municipal executives don't agree with that statement either.

Chairman HUMPHREY. Mayor Alexander.

Mayor ALEXANDER. Again, the experts that I have submitted for the consideration of this committee disagree with Mr. Simon's conclusions on this very point.

Chairman HUMPHREY. I have taken 7 minutes for this inquiry and we are trying to speed it up. I hope some of you will be able to remain when the Secretary is here.

Mrs. Heckler will ask questions on behalf of the minority.

Representative HECKLER. I would request that I be allowed 4 minutes and then yield to my colleague from California.

I would like to say to the panel of mayors that you have been very impressive and persuasive, and to Mayor Beame, I commiserate with you. New York is a very great city and I know its present situation in extremis is painful for the whole country and certainly for you. I was interested in the comments by the mayors relating to the pressure of the tax burden on the taxpayers in your cities. I would like to relate to my own experience in government which is that there is an unofficial moratorium on tax increases. All of us in government, and every member of this Congress who will be reelected is aware of that, so that is a pressure both on you and on us. We have to measure the impact of what is happening here against that as one factor.

I think that too many can be accused of having campaigned throughout the country in many cities, in many areas, for every level of government, on the platform of promises, promises, and very few campaign on the platform of money management, that I can manage the money of a city well, or I can manage the money of the Federal Government well. Unfortunately I have to question what public support there would be for that platform, quite realistically.

Nonetheless, money management is a key factor in your role and our role and I think the voters are going to look very hard at us this time in terms of how we get results. So I question Mayor Beame on his very sincere efforts to cut back costs in New York. While you have taken the steps you have recited, what has been the reaction of the public in New York to your austerity progrm? You have had teachers strikes and layoffs, and so forth. Is the public accepting your program as being in the best interests of the citizens of the city?

Mayor BEAME. Well, certainly the public is suffering.

Chairman HUMPHREY. Will you pull the microphone over, please.

Mayor BEAME. I say the public is suffering, as you indicated, by reason of the fact that we have demonstrations down at City Hall, at the Mansion, and all over town, even in front of the Governors office, by all of the groups who have been affected.

I will say, however, that the people of the city of New York understand the problem and are suffering along with us. They are cooperating. But we reduced the garbage collections, reduced our police force, we have reduced our fire protection. We have cut down on social services and day care centers so that working mothers can't go as—at the least the numbers of working mothers obviously are going to be restricted. And in every vital service in our city we have cut down and cut across the board. And as I indicated, it best can be demonstrated by the protests.

Representative HECKLER. So you say the public is not accepting these cutbacks?

Mayor BEAME. They are, of course. They have no choice. I certainly don't like to see police protection cut down. I don't like to see garbage collection—New York City is—it is a city to entry. Millions of people come in from around the country and from foreign countries and if they see garbage piled up, they don't get a good impression of our city, but we have these problems. We have cut our forces by almost a third in the sanitation department.

Representative HECKLER. I think that the problems are well documented. The fact is, however, that as one who believes in compassionate government, let me say I think it is time for some creative thinking in terms of delivery of services, innovative thinking in terms of finding answers to problems which just simply is not throwing money into the problem, and I think the public will demand that.

I voted against the Lockheed loan bill because of the precedent it would set, and I have misgivings about this situation because of the enormous debt of $700 million, now $3 billion in another account, and because of the potential drain on the funds and the precedent.

Now, I would like to have a better understanding of what this potential drain might be and I would like to ask three of the mayors to give the committee the amount—state for the record the amount of their deficit in their capital accounts at this time. Now, as I understand it, your deficit in New York is in the operating account. I would like to ask the Mayor of Detroit what the deficit in his capital account is.

Mayor YOUNG. If by that you mean how many—how much in bonds we have outstanding—is that your question? We have no deficit.

Representative HECKLER. You have no deficit.

Mayor YOUNG. We have bonds outstanding which we are paying.

Representative HECKLER. All right. What is the amount of the bonds that are outstanding?

Mayor YOUNG. I would say approximately $80 million in bonds. I might also indicate in answer to your last question as to whether or not the people are accepting this matter, the people are not accepting this matter in the City of Detroit. They are not accepting reduced police service, they are not accepting reduced services because—primarily because they know and Congress should know that we send money from our cities to the Federal Government. Michigan State is in the top 5 or 6 in money going in and the bottom 40 of money coming back. So I think the Congress ought to consider that. The people around this country in the cities expect some of their money back in the form of relief. They are not accepting it. This is rejection.

Representative HECKLER. People are not accepting these cutbacks. At the same time they are——

Mayor YOUNG. They are not accepting the refusal of the Federal Government to send some of their money back to the cities that the cities send to the Federal Government.

Representative HECKLER. Well, I think they have accepted our revenue sharing and I also feel——

Mayor YOUNG. That is less than we were getting before, Congresswoman.

Representative HECKLER. I apologize for that because I don't think that is fair, but I do feel the people will not accept cutbacks from the Federal Government either. Therefore, with limited resources both here and in our States and in our cities, somehow there has to be a definite recognition of what government should do and government has to do things more effectively, more innovatively, and less expensively if we are to have the confidence of our people, whether they are from your area or mine.

Now, in view of the fact that we do not have time, I just would ask Mayor Alioto, because he is the success story and he has financial stability in his community, do you have—how much do you have in outstanding municipal bonds for capital improvement in the city of San Francisco?

Mayor ALIOTO. I don't have that figure immediately, but the study you had last week finds us well within manageable limits, well within manageable limits.

But we still feel, as I say, the top executives of the Bank of America, that the New York default is going to have very damaging impact on our ability to get equitable interest rates from here on in, even San Francisco.

Representative HECKLER. Mr. Chairman, I would like to yield to my colleague from California, Mr. Rousselot.

Representative ROUSSELOT. Mr. Chairman, I know the time is limited, so I will just say to my good mayors here, that are here, if you would like to respond in writing, we would be glad to have it.

Mayor Alioto, I was interested in your comments that you said the Federal policy has in fact been responsible for many of the problems of the cities and I am sure you couldn't outline that all in a few seconds, but could you state a few of those?

MAYOR ALIOTO. Just a few. I think the flight to the suburbs was encouraged by Federal programs relating to highways and relating to housing and financing of housing in the suburbs only and not in the cities. I think that is a key there.

Representative ROUSSELOT. Is your answer to that that we should stop that?

Mayor ALIOTO. Excuse me——

Representative ROUSSELOT. Is your answer to that financing in the suburbs that we should stop?

Mayor ALIOTO. No. I didn't suggest that. There should have been a balanced financing of the cities at the same time so that you would not incurred this exodus to the suburbs which has produced the problem in so many cities. There should have been a balanced financing both in the suburbs and the cities with greater emphasis, indeed, on the cities themselves, and I think that would have stopped it, but the failure to recognize that welfare, you know, involves a vast immigration from various parts of the country to certain desirable places in the country is really a Federal problem and when you impose this overburdening cost upon the cities you contribute to their financial instability. You put them on the road.

Representative ROUSSELOT. When the Federal Government forces that.

Mayor ALIOTO. I think the failure of the Federal Government to recognize that it was a national problem because of the vast immigrations that took place, the vast migrations that took place to certain cities in this country, the failure to recognize and pick up that cost has imposed a financial burden upon the cities they just weren't able to stand.

Representative ROUSSELOT. You also stated the Federal Government has been part of the problem of causing raging inflation. Do you want to comment on that, how we have done that?

Mayor ALIOTO. Well, all I am saying is that no city can be held responsible for inflation. The city can't be held—in other words, that is more properly a problem that ought to be addressed by the Federal Congress than by a city council.

Representative ROUSSELOT. Is the Federal deficit financing an impact on your capability in the bonding markets?

Mayor ALIOTO. Well, there isn't any doubt that deficit financing has some inflationary effects. Nobody would deny that. But here again, you know, you have to have a balance upon the services that have to be performed for those who live in the cities where the city crisis has been caused not by the cities themselves. So, of course, you balance all these things, but I think it is very clear that no city council is supposed to address itself to the national inflationary factor.

Representative ROUSSELOT. Mr. Chairman, I know the time is limited and you have been nice enough to yield us some time. I would like Mayor Beame, if he could in writing, tell us some of the other things that he plans to do to cut back on expenditures to meet some of the demands the State legislature has put upon you.

Mayor BEAME. I can answer it in one sentence, that under the law we must have by 1977–78, a balanced budget using an accounting system wherein everybody is on a cash basis.

Representative ROUSSELOT. Do you think the Federal Government could learn by that experience?

Mayor BEAME. I am sure they can.

Senator RIBICOFF. Mr. Chairman, to highlight the points that Mayor Alioto made to Congressman Rousselot's query, could I just give you two statistics? New York City suffered an outmigration of 464,000 people between 1970 and 1974 and lost 471,000 jobs since 1969. At the same time that New York City, like other major cities, was having this outmigration of people and jobs, there was a fantastic large inmigration from Puerto Rico and the South which added tremendously to the welfare rolls and the requirements of social services. So, you have the middle class and jobs going out and the poorer and the people on welfare coming in, which is one of the basic problems.

I just wanted to put that footnote to you, Mayor Alioto.

Mayor BEAME. Mr. Chairman, may I just mention one number that will show the significance? The welfare and medicaid budget in New York City, that New York City's budget incorporates, amounts to $4 billion. If that were not a city burden, our budget would be cut by a third, from $12 to $8 billion.

Chairman HUMPHREY. Yes.

Representative ROUSSELOT. Mr. Chairman, I wonder if we could have from the city mayors, when they do take a referendum among their mayors, what the results of that are on this subject of whether the Federal Government should provide a Lockheed-type guaranteed loan. I would be interested in what the referendum provides. I know what the referendum is here obviously. I mean your total membership.

Mayor BARCELO. We take a referendum only in our Board of Directors, National League of Cities.

Representative ROUSSELOT. You aren't going to take a referendum among your entire membership?

Mayor BARCELO. No. Just among the members of the board of directors.

Chairman HUMPHREY. What about the U.S. Conference of Mayors, Mayor Landrieu?

Mayor LANDRIEU. May I say to you, Mr. Chairman, that this group of mayors here represents the executive board. There are a number of past presidents here and we think that we have some sensitivity as to what the problem in New York City is and how the mayors across this country view it. I don't tell you obviously that out of the thousands of mayors in this country that that position is unanimous, but I think an overwhelming majority of the mayors favor such a loan or guarantee to New York City without any fear that any other city is going to rush to take advantage of it because under those proposals for a city to be eligible for that kind of a guaranteed loan, you virtually have to drive yourself to the brink of bankruptcy.

Mayor PERK. Senator——

Chairman HUMPHREY. Yes, Mayor Perk.

Mayor PERK. In answer to some of the questions I might point out that in Cleveland we have no operating deficit. We will be balancing our budget this year, 1975, with a small surplus. But that—and we have sufficient millage to retire the bonds that are now outstanding, but that doesn't mean because Cleveland is financially stable that the Federal Government should not study as many alternatives as possible to help New York.

I am suggesting that the Federal Government study as many alternatives as possible. Perhaps the two recommendations made by Mayor Moon Landrieu and Mayor Beame are probably only two. Perhaps there might be 10 alternatives. But this is something that you, this joint committee, and the Federal Government, the administration, may be in a position to study more alternatives without direct grants.

I think that Mayor Beame has come to the conclusion that he is not asking for direct grants, but there are—there may be other alternatives and I think that the alternatives I suggested, the municipal insurance corporation, which would insure bonds, would do several things if you look carefully at this. It would take the 7.9 percent I am paying on bonds in Cleveland on yield bonds and probably reduce it to 5 percent. If I paid 1 percent of that to the Federal Government insurance program, I would be saving almost 2 percent. I could use that 2 percent for capital improvements. And so we would be able to develop through that kind of a program something like a $2 billion or $3 billion additional capital works program, public works program, which we are asking the Federal Government to do anyhow.

So if the Federal Government is in a position to give us—to save New York through some kind of an insurance program, then the rest of us are in a position to be able to sell our bonds under the recommendation I am making at a lower rate of interest and we will be able to save money and have money available for the capital improvements we are asking you to fund through the public works program which I think was passed by the House or at least is being considered.

Chairman HUMPHREY. Gentlemen, we are very grateful to you, and may I just say that the suggestion that has just been made by Mayor Perk is one of the several that is already in the legislative hoppers. There is such a proposal in. There are other proposals along the line which you gentlemen have outlined. I just want to express our thanks for this informative session we have had. I am sure all of us recognize that we do have mutual responsibilities and you can rest assured that this committee and its staff working with other committees of the Congress will explore every possibility until we do find a sensible, responsible way to meet what is a problem not only in New York, but one that is facing other communities in this country.

Thank you very much.

Mayor LANDRIEU. Thank you, Mr. Chairman, very much.

Chairman HUMPHREY. Secretary Simon, we apologize for the delay in bringing you to the witness stand. We want to thank you very much for your cooperation in coming here before the committee. You have listened to some of the testimony of the mayors of some of our leading cities. They have made a case individually and collectively that New York City's financial problems are not only a local problem, but a State problem and a national problem. They have in their testimony demonstrated that the shadow cast by New York City has extended far beyond the State's boundaries in most of our Nation's large urban centers.

Moreover, the cities that we heard from here today are not the only ones affected, according to their testimony. Large cities all over the country are confronting soaring interest rates, and I bring this to your attention and will seek your comment, for the simple reason that they are large cities.

Philadelphia, a single-A rated city sold bonds at a net interest cost of 8.8 percent on July 21, 1975. Two days later, Chelsea, Massachusetts, also rated single-A sold bonds at a net interest of 6.7 percent. That is a 2-percent premium apparently due only to the difference in the size of the city.

On August 18, an agency of Detroit sold bonds, rated Baa at a net interest cost of 9.9 percent. One day later, Johnson County, Tennessee, incurred a net interest cost of 7.3 percent and also had an identical rating to Detroit.

For these lower rate bonds, the size premium is even higher, over 2½ percent.

I bring to your attention this because you have been in this market and maybe you can enlighten us as to why there are these differentials when the rating by the agency is identical.

The thing that disturbs me about this situation is that these cities are not guilty of fiscal irresponsibility. They have not operated on borrowed funds. They have balanced budgets. They are not experiencing deficits this year. In fact, everyone of the cities is in balance. These cities are not profligate. They have simply been singled out apparently due to size or regional location as potential New Yorks.

Mr. Secretary, this is not how an efficiently functioning free market should operate. They either ought to revise their rating system or get with it on the interest rates. Rather, it is a modern-day version as I see it of guilt by association.

Moreover, according to Frank Wille, Chairman of the Federal Deposit Insurance Corporation, a major bank regulatory agency, the problems are not confined to the municipal bond markets. In a speech delivered in Durango, Colo., over the weekend, Mr. Wille indicated that the FDIC has identified approximately 100 small and medium sized banks that potentially could be regulatory problems, as he put it, if New York City should default. Surprisingly, these banks were not all located in New York State, but scattered around the country in places, in such places as Texas, Missouri, Florida, a further indication of the national significance of a New York City default.

We are not here today to find villains for New York City's malaise or to absolve those who are responsible. I think the mayors made it clear that there undoubtedly have been cities and States, including the Federal Government, that can enjoy much better management. There has already been enough talk and rhetoric on both sides and there is plenty of responsibility to be shared by all city officials, State officials, bankers, city employees, and even residents themselves. Even the Federal Government has made its contribution by permitting the present recession to sink to depths that are intolerable for most cities and I believe at this point it cannot be escaped when you look at the recession figures in Detroit, in New York City, Phoenix, Arizona, in Seattle, and other places. They are nothing short of astounding.

But even if responsibility can squarely be placed on one pair of shoulders or another, it really would serve no purpose. No doubt mistakes have been made, but the task that confronts us as a Government is not pointing fingers at past transgressions, but rather developing constructive programs if they are necessary to minimize the impact of these mistakes on innocent citizens and the rest of the Nation.

Mayor Alexander of Syracuse had some very powerful testimony pointing out that New York City bonds are in the main held by ordinary citizens who have used these bonds as a means of saving for purposes of education of their children and retirement. The solution enacted by the New York State Legislature earlier this month has given the country 3 months to assess the national economic consequences of a New York City default. It is my hope that Congress and the administration can use these intervening 3 months not to argue, but to examine this issue carefully and respond to whatever actions may be necessary to minimize the impact of New York's financial problems on the rest of the Nation.

I am very glad that you could be here during some of the testimony, Mr. Secretary, because there will be questions, of course, that we shall ask relating to the testimoy of the mayors.

Finally, may I say that when we talk of a city we are not talking about brick and mortar. I was a mayor of a city. We are talking about people and I think the point that was emphasized here today is that we are talking about services to people. We are talking about their basic needs. And the question has to be asked, what will happen if a great city the size of New York defaults not only in its bonds, but defaults on its services? What will be the economic and political repercussions? Will it be violence? Will it be apathy? Will it be erosion, obsolescence? I think we have to ask.

My point is I would like to be as interested in New York City as the International Monetary Fund was recently in the development of the developing world, and believe me, as chairman of the Committee on Foreign Assistance, if we don't get some action, we are going to put it right on foreign assistance some place along the line because we are just not going to have an example of saving a city in Afghanistan and letting a city go down the drain in New York.

Now, Mr. Secretary, go ahead. [Applause.]

STATEMENT OF HON. WILLIAM E. SIMON, SECRETARY OF THE TREASURY

Secretary SIMON. I am delighted to be here today, Mr. Chairman. [Laughter.]

I don't expect to be able to take this complex subject of municipal financing of cities and how the municipal market has built up over the years and create a great understanding of the anomalies that exist not only in this market, but in any market or to explain; for example, why there is a variation in the price that is paid by New York City with an A rating for most of the time, as opposed to other A-rated cities. Supply is the major reason and the impending problems of the city have always caused a higher interest rate for New York City.

I would suggest if you are going to have these hearings go on for some time that it would be useful for you to bring down the Standard & Poors and Moody rating services who provide all of the statistical analysis to develop these ratings as to how they do it and how the various interest charges relate. I think it would be very informative to you.

Chairman HUMPHREY. We have the testimony this morning from Moody Services as to what default would mean and——

Secretary SIMON. I wasn't talking about that. I was talking about a functioning municipal market and why there are indeed variations.

Chairman HUMPHREY. Oh, yes.

Secretary SIMON. This is an occasion, Mr. Chairman, that none of us can welcome. All of us share the hope that a default can be avoided. Personally, I am confident that if the proper steps are taken, default is going to be avoided. One of the great pleasures in my life was to spend some 20 years working in that financial community. I gained from that experience not only a love for the city, but also enormous respect for the wisdom and strength of the people of the city.

As your invitation to me recognizes, however, it is also important that we seek to understand what the implications would be if default does occur. I am sure that the members of this committee, as well as the American people, want this inquiry to be as honest and objective as possible. This can't be a time when we delude ourselves with excessive optimism and thus fail to act wisely. At the same time, we can't engage in excessive pessimism. Impassioned statements that a default would have catastrophic consequences for the financial markets as well as for our economy, statements which really have no foundation in observable fact, can only make the situation worse. This is a time, then, for an honest appraisal, devoid of emotionalism or partisanship. My testimony today is offered in that spirit.

I have appeared before this committee many times to discuss economic as well as financial issues. I have enjoyed our dialogs and I recognize their value in exposing your colleagues in the Congress and the Nation to a wide range of views on the issues which confront us.

This committee has an obligation to inquire into the major economic matters which face our country and I have a corresponding obligation to present the administration's views: Responsively, accurately, and fairly. And neither of us meets these obligations unless we deal with all sides of the issues: the unlikely as well as the likely, the worst case as well as the best case.

Moreover, these obligations extend beyond evaluation. To the extent we identify the potential for harm in a default, we must implement measures designed to minimize this harm in the event default occurs. Properly designed, such measures should not enhance the possibility that default will occur. Nor should they reflect a judgment that a default will necessarily occur. They simply involve this government carrying out one of its most important roles. Protecting its citizens.

It is for these reasons that we have carefully evaluated the potential impact of default, because default has two aspects—the objective and the psychological. Any evaluation of the impact must involve highly subjective judgments. Absolute certainty is most simply not possible.

With these considerations in mind, let me outline the substance of my remarks today.

First, although the challenges and the task are great, New York City, with the assistance of the State, has both the mechanisms and the resources to avoid default.

Second, if default were to occur, the event would be primarily legal in nature: The political and social infrastructure of the city would remain intact.

Third, while a default could adversely affect the capital markets, the effect in my judgment would be tolerable and temporary.

Fourth, a default would cause little, if any, damage to our financial structure: The banking system would remain intact, no bank customers would lose their deposits, and the system would continue to be able to provide credit to all levels of the economy, including consumers.

Finally, the costs and risks associated with any program to provide special Federal financial assistance to prevent default substantially outweigh the benefits which prevention would provide.

At the President's request, I have put together an informal interagency task-force, chaired by my Under Secretary, Edwin H. Yeo III, to deal with every aspect of a potential default by New York City. The evaluations and the plans outlined in my testimony today are the result of these efforts.

Working through this group, and with the cooperation of other agencies of government, we have developed a program designed specifically to minimize harm in the event of a default. Particular aspects of the program are described in detail throughout my testimony, but let me summarize them.

To complement action by the State legislature, we have prepared, and will shortly submit to the Congress, legislation amending chapter 9 of the Federal Bankruptcy Act to facilitate use of the protections of that act by New York City. In addition, we are also studying the feasibility of a chapter 11 type reorganization procedure as an alternative mechanism.

We will continue to provide for the flow of Federal assistance payments to New York City.

To protect the banking system and thus assure the continued availability of resources that system provides to consumers, corporations, and governments, the FDIC will, in appropriate cases, provide capital to institutions where such action is necessary to maintain their solvency. Moreover, as Chairman Burns reported to this committee earlier this month:

> The Federal Reserve will act promptly to relieve liquidity strains on the banking system, whatever the cause of those strains may be.

Let me repeat, default can be avoided. But it is our responsibility—to the Congress and to the Nation—to design programs for any eventuality.

Let us now consider the current efforts of New York City and New York State to prevent a default.

I outline in my prepared statement, what has occurred in the past 3 weeks in the State.

Meanwhile, Mayor Beame has appointed a top financial executive to serve as the chief financial officer of New York City and to develop by mid-October an expense reduction plan.

These laudable efforts reflect a renewed sense of dedication to attack the causes of the problems I discussed with Congressman Rosenthal's subcommittee in June. Will these measures work? Can the city do enough between now and December to restore investor confidence? Some have answered in the negative, but I cannot agree. I would be less than candid with this committee if I suggested the task is going to be easy. I would be less than candid if I failed to say that more in the way of immediate actions—immediate expense reductions—is required now than would have been required at some earlier time. But it would be equally untruthful to suggest that the job cannot be done. Appropriate mechanisms are now in place. It is essential that they be used promptly and well.

To set the framework for my analysis of the impact of default, it is important to define some relevant terms and concepts.

My description of insolvency, liquidity, default, and bankruptcy are important in a legal as well as a practical sense to compared municipalities, vis-a-vis, an individual or a corporation. We arrive at the conclusion that the essential services in New York City indeed will continue in the event of a default.

It is important to reemphasize this point, that if New York City defaulted, it would continue to exist and to operate. Tax payments, Federal and State assistant payments, and other sources of revenue would continue to flow. Schools and hospitals would remain open. Police, fire, and sanitation services would be provided and paid for.

In short, it is essential not to confuse the legal and idiomatic meanings of the term "bankruptcy." In common parlance, we may use bankruptcy to define a condition devoid of substance or sources. By that definition, New York City does default, however, to deal with its creditors in an orderly way, a proceeding under the Federal bankruptcy laws is the most appropriate solution.

As I have often said, no observer who is asked to predict the impact of a default can do so with absolute certainty. A default—like any major financial reversal—has two aspects: Tangible and the psychological. It would be inadequate to limit the analysis to only one of these aspects. And confusing the two would further cloud our evaluation of the impact of default. Indeed, I sense that such confusion is in large part responsible for some of the more extreme predictions which have been made in recent weeks.

Moreover, as I cautioned in my letter of last week, it is important to be sensitive to the risk that the evaluation process itself may aggravate reaction to a default. Let us suppose, for example, that leaders of major financial institutions contend that their institutions and the markets in which they function would be devastated by a default. Objective factors notwithstanding, such contentions would measurably enhance the impact of default.

Let me turn to a sector-by-sector analysis.

If New York City defaulted on an obligation to redeem a maturing note issue for cash, a question of immediate importance is whether the city could continue to provide essential services: Police and fire protection, sanitation, mass transit, water and sewerage facilities, and the like. We evaluated the city's level of receipts. While, as I have indicated on earlier occasions, levels of outlay for these services are extreme in relation to the outlays of other cities, New York City's revenues appear sufficient to provide an adequate level of services in the event of default.

Another potential concern relates to continuation of the various Federal assistance programs. The Office of Management and Budget and the Domestic Council have completed a survey of the most important of these programs with the objective of identifying the potential consequences on scheduled assistance flows in the event local mechanisms temporarily become unavailable. As the committee knows, certain assistance to the city and its citizens depends upon local matching funds. The great bulk of this assistance is matched by the State of New York. However, under State law, the city is required to provide some share of the State portion. In our view, and under current Federal law, the State is responsible to make the matching payments.

I then talk about the overall welfare problem, a longer range problem to which the President has assigned Vice President Rockefeller, who will conduct nationwide hearings on the subject of future Federal responsibilities in that area.

The requirement that the city continue to provide and finance essential services underscores the importance of insuring that there is an orderly mechanism for allocating the city's financial resources and effecting a restructuring of the short-term debt. Absent such a mechanism, there is the risk of a multitude of lawsuits.

It is for this reason that we have prepared, and will submit shortly to Congress, legislation amending chapter 9 of the Federal Bankruptcy Act. This legislation is designed to insure that the claims of all legitimate creditors would be dealt with in a single proceeding. It would be complementary to the legislation that has already been enacted by the New York State Legislature. And then I point out specifically what the legislation would provide. In assessing the impact we are dealing in the realm of judgment. As I have said, absolute certainty is simply not possible.

First, the enormous volume of tax-exempt securities coming to market—more than $51 billion of bond and notes in 1974 and more than $40 billion in the first 8 months of this year alone—has not been matched by a corresponding increase in demand for such securities. Second, inflation and now its inevitable handmaiden—the anticipation of future inflation—caused by massive Federal demands on the market has dampened investor interest in committing funds for the long term. Finally, a series of events—the repeal of the port authority covenant by the legislatures of New York and New Jersey; the default by UDC, occasioned by the New York State Legislature's initial refusal to carry out its "moral obligation;" and the problems of New York City itself—have all sharpened investor awareness of risk and created an element of doubt about the willingness of public bodies to carry out their financial obligations.

To a significant extent, these doubts have already led to some adjustments in the market. In the event of default, we would expect only a temporary period of moderate adjustment. And over a slightly longer time frame, we can see some potentially favorable signs. We understand that numerous intermediaries and investors are currently withholding funds from the municipal market because of the current uncertainties. When the New York City situation is resolved—one way or another—we can expect a substantial return of funds to the market, improving liquidity and lowering borrowing costs.

But the implications of default are broader than short range fund flows or price adjustments. Since at least the beginning of this decade, there has been a marked increase in the tendency of investors to restrict themselves to higher-grade instruments—or a "flight to quality," to use the terminology of the market. Inflation and its by-products is the primary cause, but there is little question that major financial reversals—the Penn-Central bankruptcy, for example—have served as important catalysts.

Clearly, New York City's situation has caused this trend to accelerate. Issuers whose obligations are viewed as less than prime are paying high rates of interest relative to the general structure of interest rates. Conversely, well-run issuers are benefiting in the form of lower rates.

In short, when we move away from this period of uncertainty, underlying credit characteristics—financial soundness—will be the dominant factor in the pricing of all municipal debt. The result will be a better and more efficient municipal bond market.

At the same time, we cannot ignore the way in which the municipal market has performed even under these seriously unsettled conditions. During August alone, four States and 255 municipalities raised nearly $2.6 billion in long-term debt. And contrary to widely held opinion, such funds were raised at a cost not grossly disproportionate to historical levels.

Traditionally, there has been a 30-percent spread between tax-exempt and taxable issues of comparable quality. When we hear complaints about the record rates municipalities are paying for funds, we must keep in mind that conditions in the corporate market are no better. This month, the spread between long term prime municipals and comparable utility issues was squarely on the 30 percent figure.

This is not to suggest that the municipal market has not been impacted by the uncertainty surrounding the problem. But it does place the reaction of the market in a more accurate perspective than some of the rhetoric.

Finally, the disruptions which have occurred in the market place can provide an impetus for some very important reforms. One reason our capital markets are the finest in the world is that, under our laws and procedures, investors are provided with detailed and accurate information concerning potential investments. To the extent investors begin to receive some information from tax-exempt issuers, the market will clearly benefit.

As the committee is aware, the Treasury Department, in conjunction with the Comptroller of the Currency, the Federal Reserve Board and the FDIC, has taken a close look at the holdings of New York City securities in our banking system. While significant amounts of New York City's debt is held by commercial banks, we do not believe a default would have a serious impact on the banking system.

Specifically, our analysis revealed that only an infinitesimal percentage of the Nation's 14,000 commercial banks could face serious capital impairment if New York City defaulted. Moreover, all of the Nation's larger banks would be secure in the event of default.

But as is the case in other areas, we have felt an obligation to develop mechanisms to minimize all risks, however small. Accordingly, with respect to any bank which may be impacted, we have designed various mechanisms. Bank customers have no need to fear for their funds.

One, where possible, bank directors will be required to contribute additional capital.

Two, certain banks may be sold to, or merged with, other banks or bank holding companies.

Three, as a last resort, in appropriate cases, the FDIC may provide capital such as in the form of convertible subordinated debt, at the same time imposing appropriate sanctions on the bank officials directly and indirectly responsible for the bank's exposure.

In addition, in recognition of the likelihood that any default could be cured promptly, the bank regulatory agencies have agreed that in the event of default, no bank will be required to write down its holdings to market for 6 months.

As I suggested earlier, we cannot conclude that a default by New York City would result in a broad-based decline in consumer or investor confidence or in the adoption of unnecessarily restrictive lending policies by financial institutions.

The only event which could modify this conclusion would be the provision of Federal financial assistance to avert a default. Indeed, such assistance—be it in the form of a guarantee or a loan, insurance or a grant—would, in my view, cause many problems for the process of recovery.

As the chief financial officer of this great country, I have a responsibility to all the people, not simply to particular groups or sectors at particular times. My job, in essence, is to protect and restore the eroding fiscal and financial integrity of this country for the benefit of every citizen. To state my views on special financial assistance for New York City most directly: I would be ignoring this fundamental responsibility if I were to support this.

For years, government at all levels has been promising more than it can deliver. This is the cause of New York City's problem and, in my view, it is the cause of our severe problems at the Federal level as well. More and larger deficits and the increased level of Federal borrowing to finance these deficits have combined to threaten our economic system with fundamental change: No longer can we be confident that our private sector will have access to the capital required if it is to meet the needs of all our citizens. Yet some would have us accelerate these changes to deal with the consequences of fiscal irresponsibility at the local level.

Any form of financial assistance would directly increase the burden the Federal Government imposes on the capital markets. Who would suffer? All borrowers, including every other State and local government, would pay higher interest rates. And certain sectors—housing, small and medium-sized companies, for example—could discover that funds were not available at any price.

Moreover, we do not escape these problems by making the assistance slightly less direct; by providing a guarantee or insurance for municipal debt. Indeed, such a program would create a security superior to those of the Federal Government itself: Backed by the full faith and credit of the United States and exempt from Federal taxes. The impact on any municipal issuer which did not have a guarantee would be direct and severe: The guaranteed bonds would skim the cream of the market and all other issuers would pay higher taxes.

And what would such a program do to fiscal policies at the local level? Today, the desire to maintain access to credit at the lowest possible rate is the most important incentive for fiscal restraint. A Federal guarantee program would provide all participants with the credit of the United States: This critical restraint on spending would be lost entirely.

But, some will ask, why not have the Federal Government impose these restraints as a condition for the guarantee? That possibility concerns me more than any other because it would amount to no less than a Federal takeover of the fiscal and financial decisionmaking process at the State and local level.

We would have to create a new bureaucracy, simply to concoct and enforce the guidelines as to local priorities we here in Washington would be imposing on the governments of the Nation. We would be confronted with the sorry spectacle of duly elected local officials lining up outside my door, attempting to persuade me that they were carrying out their responsibilities in a satisfactory fashion. We would, in short, be contravening constitutionally imposed principles of federalism; principles which lie at the heart of the structure of government in this Nation.

Thousands, perhaps tens of thousands, of governments would resist this intrusion into local affairs. And they would be absolutely right. But in the final analysis, theirs would be a Hobson's choice: Submit to Federal control or pay the price of independence in the bond markets. Are we really prepared to inflict this choice on the country?

Finally, there are those who say that New York City is a special case; that helping New York will not obligate us to help other cities in the future. But we are already obligated. We are obligated to local officials throughout the country who have risked their careers by insisting on fiscal restraint. Would financing the deficits of New York City be consistent with our obligation to them? And can we really draw the line at New York City? I doubt it. Assistance to one city would create an intolerable precedent for the future.

Before concluding, I must return once again to an important point. As strong as our economy and our financial system may be, it remains somewhat vulnerable to attacks from within. We in the administration have done all we can to evaluate the risks a default presents and where possible to provide mechanisms to minimize these risks, but if I may borrow a thought from Justice Holmes, the most elaborate fire protection system in the world may not protect theatergoers from the man who cries "fire."

Mr. Chairman, fiscal restraint is not an easy task for any economic unit in our society—a person, a corporation, a partnership, or a city. I do not want to deviate from the subject at hand, but I must point out that even we as a Nation are not immune. Only our printing press allows us a greater opportunity for postponement, while we daily risk mortgaging away the financial health and prosperity of future generations.

But our economy—however weakened by excesses at the Federal level—remains able to withstand even the most severe shocks. I do not wish a default upon New York City. I do not believe it has to default and I expect it to take the measures necessary to avoid such an event. But if it does default, the economy of this Nation and its financial system will survive, with enough strength not only to repair the damage, but also to start our greatest city along the road to recovery.

Thank you, Mr. Chairman.

[The prepared statement of Secretary Simon follows:]

Prepared Statement of Hon. William E. Simon

New York City's Financial Situation

Mr. Chairman and members of this distinguished committee, I am here today at the express invitation of the Chairman, who has called upon me to testify about the possible impact of a financial default by New York City.

This is an occasion that none of us can welcome. All of us share the hope that a default can be avoided. Personally, I am confident that if the proper steps are taken, default will be avoided. One of the great pleasures in my life was to spend some 20 years working in the financial community in downtown Manhattan.

I gained from that experience not only a love for the City but also enormous respect for the wisdom and strength of its people. I sincerely believe that if those great resources are properly marshaled, New York City will emerge from its current difficulties.

As your invitation to me recognizes, however, it is also important tha we seek to understand what the implications would be if default does occur. I am sure that the Members of this Committee, as well as the American people, want this inquiry to be as honest and objective as possible. This cannot be a time when we delude ourselves with excessive optimism and thus fail to act wisely. By the same token, we should not engage in excessive pessimism. Impassioned statements that a default would have catastrophic consequences for the financial markets as well as the economy—statements which have no foundation in observable facts—can only make the situation worse. This is a time, then, for an honest appraisal, devoid of emotionalism or partisanship. My testimony today is offered in that spirit.

I have appeared before this Committee many times to discuss economic and financial issues. I have enjoyed our dialogues and I recognize their value in exposing your colleagues in the Congress and the nation as a whole to a wide range of views on the issues which confront us.

Our job today is not a pleasant one. This Committee has an obligation to inquire into the major economic matters which face the nation and I have a corresponding obligation to present the Administration's views: responsively, accurately and fairly. And neither of us meets these obligations unless we deal with all sides of the issues: the unlikely as well as the likely, the worst case as well as the best.

Moreover, these obligations extend beyond evaluation. To the extent we identify the potential for harm in a default, we must implement measures designed to minimize harm in the event default occurs. Properly designed such measures should not enhance the possibility that default will occur. Nor should they reflect a judgment that a default will necessarily occur. They simply involve the Government carrying out one of its most important roles: protecting its citizens.

It is for these reasons that we have carefully evaluated the potential impact of default. Because default has two aspects—the objective and the psychological—any evaluation of the impact must involve highly subjective judgments. Absolute certainty is simply not possible.

With these considerations in mind, let me outline the substance of my remarks today.

First, although the challenges and the task are great, New York City, with the assistance of the State, has both the mechanisms and the resources to avoid default.

Second, if default were to occur, the event would be primarily legal in nature: the political and social infrastructure of the City would remain intact.

Third, while a default could adversely affect the capital markets, the effect in my judgment would be tolerable and temporary.

Fourth, a default would cause little, if any, damage to our financial structure: the banking system would remain intact, no bank customers would lose their deposits, and the system would continue to be able to provide credit to all levels of the economy, including consumers.

Finally, the costs and risks associated with any program to provide special federal financial assistance to prevent default substantially outweigh the benefits which prevention would provide.

The administration program

At the President's request, I have put together an informal inter-agency taskforce, chaired by my Under Secretary Edwin H. Yeo III, to deal with every aspect of a potential default by New York City. The evaluations and the plans outlined in my testimony today are the result of these efforts. We did not, however, feel that it would serve anyone's interests to publicize the activities of this group until this time.

Working through this group, and with the cooperation of other agencies of government, we have developed a program designed specifically to minimize harm in the event of a default. Particular aspects of the program are described in detail throughout my testimony, but let me summarize it now.

"To complement action by the State Legislature, we have prepared, and will shortly submit to the Congress, legislation amending Chapter 9 of the Federal Bankruptcy Act to facilitate use of the protections of that Act by New York

City. In addition, we are also studying the feasibiilty of a Chapter 11 type reorganization procedure as an alternative mechanism.

"We will continue to provide for the flow of Federal assistance payments to New York City.

"To protect the banking system and thus assure the continued availability of resources that system provides to consumers, corporations and governments, the FDIC will, in appropriate cases, provide capital to institutions where such action is necessary to maintain solvency. Moreover, as Chairman Burns reported to the Committee earlier this month: 'the Federal Reserve will act promptly to relieve liquidity strains on the banking system, whatever the cause of those strains may be.' "

Let me repeat, default can be avoided. But it is our responsibility—to the Congress and to the nation—to design programs for any eventuality.

Current status

Let us now consider the current efforts of New York City and New York State to prevent a default.

On September 9, a special session of the New York State Legislature enacted legislation calling for:

Creation of a State dominated Emergency Financial Control Board to assume plenary control over the City's finances;

Authority to issue $750 million in short term State notes, the proceeds to be used to purchase MAC bonds;

A mandate to State and City employee pension plans to purchase $750 million in MAC bonds (and relief for the State Comptroller with respect to his fiduciary responsibilities regarding these plans);

An increase in MAC's borrowing authority from $3 billion to $5 billion; and,

Authorization for the City to file a petition in bankruptcy under Chapter 9 of the Federal Bankruptcy Act.

Two days later, New York State sold $755 million of short term notes, including $250 million earmarked for the City. MAC is beginning to raise from other sources the $800 million necessary to complete the $2.3 billion package which is required to finance the City through December 1.

At the City level, meanwhile, Mayor Beame has appointed a top financial executive to serve as the chief financial officer of New York City and to develop, by mid-October, an expense reduction plan to return the City to a sound fiscal basis.

These laudable efforts reflect a renewed sense of dedication to attack the causes of the problems I discussed with Congressman Rosenthal's subcommittee last June. Will these measures work? Can the City do enough between now and December to restore investor confidence? Some have answered in the negative, but I cannot agree. I would be less than candid with this Committee if I suggested the task will be easy. I would be less than candid if I failed to say that more in the way of immediate actions—immediate expense reductions—if required now than would have been required at some earlier time. But it would be equally untruthful to suggest that the job cannot be done. Appropriate mechanisms are now in place. It is essential that they be used promptly and well.

Impact of a default: Necessary concepts

To set the framework for my analysis of the impact of default, it is important to define some relevant terms and concepts. I sense that the dialogue concerning the issue has been hampered by confusion over the meaning and import of certain key words. First, there is "insolvency" which, simply stated, means that a person or a city has current obligations which exceed its available funds. "Default" is a technical legal term describing a debtor's refusal or inability to pay a creditor who has demanded payment. "Bankruptcy" describes a legal proceeding—provided for in the Constitution—under which an insolvent party in default turns over to a court the job of deciding how his financial resources will be apportioned among creditors.

In looking at default and bankruptcy, we should also draw a distinction between the options available in the event of a corporate default and those available with respect to a municipal default. If a corporation defaults and is subsequently brought under the jurisdiction of a federal bankruptcy court, one option—albeit often not the most desirable one—is liquidation: the sale of assets to satisfy the claims of creditors and the subsequent disappearance of the corporation as a continuing entity. Both common sense and Constitutional principles preclude such an option with respect to municipal defaults.

In this respect, a default by a state or local government is closely analogous to a default by an individual person. In either case, if a bankruptcy proceeding ensues, resources essential to the maintenance of life in the one case and essential services in the other, are protected from the demands of creditors.

It is important to re-emphasize this point: If New York City defaulted, it would continue to exist and to operate. Tax payments, Federal and State assistance payments and other sources of revenue would continue to flow. Schools and hospitals would remain open; police, fire and sanitation services would be provided and paid for.

In short, it is essential not to confuse the legal and idiomatic meanings of the term bankruptcy. In common parlance, we may use bankruptcy to define a condition devoid of substance or resources. By that definition, New York has not been, is not now, and will not be bankrupt. If New York City does default, however, to deal with its creditors in an orderly way, a proceeding under the Federal bankruptcy laws is the most appropriate solution.

As I have often said, no observer who is asked to predict the impact of a default can do so with absolute certitude. A default—like any major financial reversal—has two aspects: a tangible, objective aspect on the one hand and a psychological aspect on the other. It would be inadequate to limit the analysis to only one of these aspects. And confusing the two would further cloud our evaluation of the impact of default. Indeed, I sense that such confusion is in large part responsible for some of the more extreme predictions which have been made in recent weeks.

Moreover, as I cautioned in my letter of last week, it is important to be sensitive to the risk that the evaluation process itself may aggravate reaction to a default. Let us suppose, for example, that leaders of major financial institutions contend that their institutions and the markets in which they function would be devastated by a default. Objective factors notwithstanding, such contentions would measurably enhance the impact of default.

Let me turn to a sector-by-sector analysis.

Essential services

If New York City defaulted on an obligation to redeem a maturing note issue for cash, a question of immediate importance is whether the City could continue to provide essential services: police and fire protection, sanitation, mass transit, water and sewerage facilities, and the like. We evaluated the outlays required to provide these services against the City's level of receipts. While, as I have indicated on earlier occasions, levels of outlay for these services are extreme in relation to the outlays of other cities, New York City's revenues appear sufficient to provide an adequate level of services in the event of default.

Federal assistance programs

Another potential concern relates to continuation of the various Federal Assistance programs which benefit the citizens of New York. The Office of Management and Budget and the Domestic Council have completed a survey of the most important of these programs with the objective of identifying the potential consequences on scheduled assistance flows in the event local mechanism temporarily become unavailable. As the Committee knows, certain assistance to the City and its citizens depends upon local matching funds. The great bulk of this assistance is matched by the State of New York. However, under State law, the City is required to provide some share of the State portion. In our view, and under current Federal law, the State is responsible to make the matching payments if the flow of Federal assistance is to continue.

Speaking more broadly, programs of assistance to the disadvantaged are fundamental in a compassionate democratic society. But if such programs lose the support of the American people—if they are perceived as too often providing the wrong benefits to the wrong recipients—our ability to provide any assistance of this nature will be limited.

For these reasons, the President has asked Vice President Rockefeller, as Chairman of the Domestic Council, to conduct a thorough re-evaluation of all Federal assistance programs and to develop proposals for reform. While that review is not yet complete, my views are well known. I personally have long favored a simple program of income maintenance as the most efficient approach to our responsibilities in this area.

Debt adjustment

The requirement that the City continue to provide and finance essential services underscores the importance of insuring that there is an orderly mechanism for allocating the City's financial resources and effecting a restructuring of the short term debt. Absent such a mechanism, there is the risk of a multitude of lawsuits, each seeking a legal injunction against the payment of City funds to one class of creditor or another.

It is for this reason that we have prepared, and will submit shortly to Congress, legislation amending Chapter 9 of the Federal Bankruptcy Act. This legislation is designed to insure that the claims of all legitimate creditors would be dealt with in a single proceeding. It would be complementary to the legislation enacted by the New York State Legislature authorizing New York City, in the event of default, to seek reorganization of its debt under the plenary jurisdiction of a federal court.

Specifically, our proposal would modify existing law by eliminating the existing requirement that a city must file a reorganization plan and written assents to the plan from 51% of the creditors before obtaining the protection of a Federal bankruptcy court. Under the revised procedure, Federal protection would be provided upon the filing only of a simple petition by the City. As is the case with respect to other types of reorganization under our bankruptcy laws, the reorganization plan and the creditors' assent thereto would be developed in the course of the proceeding. In the interim, however, the City would be protected from conflicting claims and injunctions regarding its resources, and could continue to conduct its affairs in an orderly manner.

I would point out that this proposal is substantially consistent with the recommendations of the National Commission on the Reform of the Bankruptcy Laws, embodied in S. 235.

Financial markets

In assessing the impact of a default on the financial markets, we are dealing in the realm of judgment; as I have said absolute certainty is simply not possible. My analysis is based on a detailed review of all the factual circumstances, discussions with a wide range of market professionals in the private sector, and my own conclusions, based on more than twenty years of experience in the investment banking business.

The impact of a default on markets other than the municipal market is, in the final analysis, closely related to the impact on the overall economy. As I shall discuss more fully in a few moments, it is our judgment that a default would not damage the prospects for the Nation's economic recovery. The public understands that New York City's problems are unique in most important respects. Moreover, over the past six months and in the months to come, the public has had, and will have, ample opportunity to decide whether a default by New York City is merely representative of a more fundamental flaw in our economy. Only if such a conclusion were reached—and there is no objective reason why it should be—could we expect a serious and lasting adverse impact on these markets.

Municipal bond market

Our conclusions with respect to the municipal bond market are at once more precise and more complex. Over at least the past year, the municipal market has been unsettled due to a variety of complex factors.

First, the enormous volume of tax-exempt securities coming to market—more than $51 billion of bond and notes in 1974 and more than $40 billion in the first eight months of this year alone—has not been matched by a corresponding increase in demand for such securities. Second, inflation and now its inevitable handmaiden—the anticipation of future inflation—caused by massive Federal demands on the market has dampened investor interest in committing funds for the long term. Finally, a series of events—the repeal of the Port Authority covenant by the legislatures of New York and New Jersey; the default by UDC, occasioned by the New York State Legislature's initial refusal to carry out its "moral obligation;" and the problems of New York City itself—have all sharpened investor awareness of risk and created an element of doubt about the willingness of public bodies to carry out their financial obligations.

To a significant extent, these doubts have already led to some adjustments in the market. In the event of default, we would expect only a temporary period of moderate adjustment. And over a slightly longer time frame, we can see some potentially favorable signs. We understand that numerous intermediaries and investors are currently withholding funds from the municipal market because of the current uncertainties. When the New York City situation is resolved—one way or another—we can expect a substantial return of funds to the market, improving liquidity and lowering borrowing costs.

But the implications of default are broader than short range fund flows or price adjustments. Since at least the beginning of this decade, there has been a marked increase in the tendency of investors to restrict themselves to higher-grade instruments— or a "flight to quality" to use the terminology of the market. Inflation and its by-products is the primary cause, but there is little question that major financial reversals—the Penn-Central bankruptcy, for example—have served as important catalysts.

Clearly, New York City's situation has caused this trend to accelerate. Issuers whose obligations are viewed as less than prime are paying high rates of interest relative to the general structure of interest rates. Conversely, well-run issuers are benefitting in the form of lower rates.

In short, when we move away from this period of uncertainty, underlying credit characteristics—financial soundness—will be the dominant factor in the pricing of all municipal debt. The result will be a better and more efficient municipal bond market.

At the same time, we cannot ignore the way in which the municipal market has performed even under these seriously unsettled conditions. During August alone, four states and 255 municipalities raised nearly $2.6 billion in long term debt. And contrary to widely held opinion, such funds were raised at a cost not grossly disproportionate to historical levels.

Traditionally, there has been a 30 percent spread between tax-exempt and taxable issues of comparable quality. When we hear complaints about the record rates municipalities are paying for funds, we must keep in mind that conditions in the corporate market are no better. This month, the spread between long term prime municipals and comparable utility issues was squarely on the 30 percent figure.

This is not to suggest that the municipal market has not been impacted by the uncertainty surrounding New York City's condition. But it does place the reaction of the market in a more accurate perspective than some of the rhetoric of recent months.

Finally, the disruptions which have occurred in the market place can provide an impetus for some very important reforms. One reason our capital markets are the finest in the world is that, under our laws and procedures, investors are provided with detailed and accurate information concerning potential investments. To the extent investors begin to receive such information from tax-exempt issuers, the market will clearly benefit.

New York State and its agencies

We have taken a particularly careful look at the credits within New York State to determine whether any credit would be able to withstand an increased level of scrutiny. We now believe there is little risk that a default by New York City would directly precipitate a default by New York State or its agencies.

Impact on the banking system

As the Committee is aware, the Treasury Department, in conjunction with the Comptroller of the Currency, the Federal Reserve Board and the FDIC, has taken a close look at the holdings of New York City securities in our banking system. While significant amounts of New York City's debt is held by commercial banks, we do not believe a default would have a material impact on the banking system.

Specifically, our analysis revealed that only an infinitesimal number of the nation's 14,000 commercial banks could face serious capital impairment if New York City defaulted. Moreover, all of the nation's larger banks would be secure in the event of default.

But as is the case in other areas, we have felt an obligation to develop mechanisms to minimize all risks, however small. Accordingly, with respect to any bank which may be impacted, various mechanisms are now available to insure that none will fail as a result of a decline in the value of their holdings of New York City obligations. Bank customers have no need to fear for their funds.

1. Where possible, bank directors will be required to contribute additional capital.

2. Certain banks may be sold to, or merged with, other banks or bank holding companies.

3. As a last resort, in appropriate cases, the FDIC may provide capital in the form of convertible subordinated debt, at the same time imposing appropriate sanctions on the bank officials directly and indirectly responsible for the bank's exposure.

In addition, in recognition of the likelihood that any default could be cured promptly, the bank regulatory agencies have agreed that in the event of default, no bank will be required to write its holdings to market for six months.

Overall economic impact

As I suggested earlier, we cannot conclude that a default by New York City would result in a broad-based decline in consumer or investor confidence or in the adoption of unnecessarily restrictive lending policies by financial institutions. The American people know the reasons New York City is having financial difficulties and they know that there is little, if any, direct relationship between these difficulties and the condition of the national economy.

New York City is facing a possible default because for years it has spent far more than it takes in. New York City is facing a possible default because, until recently, it has not shown itself willing to implement the necessary reform measures required to restore confidence and regain access to the capital markets. No change in the national economic picture will measurably improve conditions in New York. And by the same token, no change in New York's condition will materially influence the economy as a whole.

Federal financial assistance

The only event which could modify this conclusion would be the provision of Federal financial assistance to avert a default. Indeed, such assistance—be it in the form of a guarantee or a loan, insurance or a grant—would, in my view, cause many problems for the process of recovery.

As the chief financial officer of this great country I have a responsibility to all the people, not simply to particular groups or sectors at particular times. My job, in essence, is to protect and restore the eroding fiscal and financial integrity of the United States for the benefit of every citizen. To state my views on special financial assistance for New York City most directly: I would be ignoring this fundamental responsibility if I were to support such assistance.

For years, government at all levels has been promising more than it can deliver. This is the cause of New York City's problem and, in my view, it is the cause of our severe problems at the Federal level as well. More and larger deficits and the increased level of Federal borrowing required to finance these deficits have combined to threaten our economic system with fundamental change: No longer can we be confident that our private sector will have access to the capital required if it is to meet the needs of all our citizens. Yet some would have us accelerate these changes to deal with the consequences of fiscal irresponsibility at the local level.

Any form of financial assistance would directly increase the burden of the Federal Government imposes on the capital markets. Who would suffer? All borrowers, including every other state and local government, would pay higher interest rates. And certain sectors—housing, small and medium-sized companies, for example—could discover that funds were not available at any price.

Moreover, we do not escape these problems by making the assistance slightly less direct; by providing a guarantee or insurance for municipal debt. Indeed, such a program would create a security superior to those of the Federal Government itself: Backed by the full faith and credit of the United States and exempt from Federal taxes. The impact on any municipal issuer which did not have a guarantee would be direct and severe: The guaranteed bonds would skim the cream of the market and all other issuers would pay higher rates.

And what would such a program do to fiscal policies at the local level? Today, the desire to maintain access to credit at the lowest possible rate is the most important incentive for fiscal restraint. A Federal guarantee program would provide all participants with the credit of the United States: This critical restraint on spending would be lost entirely.

But, some will ask, why not have the Federal Government impose these restraints as a condition for the guarantee? That possibility concerns me more than any other because it would amount to no less than a Federal takeover of the fiscal and financial decision-making process at the State and local level.

We would have to create a new bureaucracy, simply to concoct and enforce the guidelines as to local priorities we here in Washington would be imposing on the Governments of the nation. We would be confronted with the sorry spectacle of duly-elected local officials lining up outside my door, attempting to persuade me that they were carrying out their responsibilities in a satisfactory fashion. We would, in short, be contravening constitutionally-imposed principles of Federalism; principles which lie at the heart of the structure of government in this nation.

Thousands, perhaps tens of thousands, of governments would resist this intrusion into local affairs. And they would be absolutely right. But in the final analysis, theirs would be a Hobson's Choice: Submit to Federal control or pay the price of independence in the bond markets. Are we really prepared to inflict this choice on the nation?

Finally, there are those who say that New York City is a special case; that helping New York will not obligate us to help other cities in the future. But we are already obligated. We are obligated to local officials throughout the country who have risked their careers by insisting on fiscal restraint. Would financing the deficits of New York City be consistent with our obligation to them? And can we really draw the line at New York City? I doubt it. Assistance to one city would create an intolerable precedent for the future.

Before concluding, I must return once again to an important point. As strong as our economy and our financial system may be, it remains somewhat vulnerable to attacks from within. We in the Administration have done all we can to evaluate the risks a default presents and, where possible, to provide mechanisms to minimize those risks. But if I may borrow a thought from Justice Holmes, the most elaborate fire protection system in the world may not protect theatergoers from the man who cries "fire."

Mr. Chairman, fiscal restraint is not an easy task for any economic unit in our society—a person, a corporation, a partnership, a city. I do not want to deviate from the subject at hand, but I must point out that even we as a nation are not immune. Only our printing press allows us a greater opportunity for postponement, while we daily risk mortgaging away the financial health and prosperity of future generations.

But our economy—however weakened by excesses at the Federal level—remains able to withstand even the most severe shocks. I do not wish a default upon New York City. I do not believe it has to default and I expect it to take the measures necessary to avoid such an event. But if it does default, the economy of this nation and its financial system will survive, with enough strength not only to repair the damage, but also to start our greatest city along the road to recovery.

Chairman HUMPHREY. Thank you very much, Mr. Secretary. I do hope that you will be present, and I imagine you will, when the mayors meet with the President because there ought to be a very interesting colloquy on that occasion.

Since I have learned that the CIA has been reading a lot of mail, maybe they could monitor that session, too, so that we could get it. I am very serious about that. It is not a joke.

I notice that earlier today certain bankers have been—will be meeting with the President prior to the mayors coming in.

Secretary SIMON. We met yesterday.

Chairman HUMPHREY. Met with the bankers yesterday. I notice that when Mr. Burns replied to us by communication relating to some of these problems of New York City, that his emphasis was upon the fact that they would make sure that the banks were saved. I am very impressed with this, that the banks will always get first consideration.

Now, don't misunderstand me. I know the importance of a banking structure, but one of the ways to save a bank is to save the customer first instead of bailing out the mismanagement of banks, which apparently nobody seems to be disturbed about. We bailed out Franklin National Bank and the Chairman of the Federal Reserve came here and told us that they had spent the last year and a half trying to straighten out the great banks of this country that had overloaded, in many instances violated their fiduciary responsibilities, and everybody knows this is a fact. Before anybody else got any consideration, we took care of the big ones, namely the banks. And now we come along and what is your remedy for this city?

Secretary SIMON. May I respond?

Chairman HUMPHREY. Just a minute. You had your time, now I will take mine. Let's take a look at your remedy. You want to amend the Bankruptcy Act. Great. Jolly. What is that going to do for anybody?

Second, you say default is a cure. This is the same thing as saying unemployment is a cure for inflation. It runs all the way through the administration's type of ideology, economic ideology. In other words, if you are in trouble, just hit the dirt. Don't try to get a safety net out. Don't try to rescue.

I noticed in your prepared statement you point out that it is New York's situation until it is clarified—if I may be more accurate in my quote of your testimony, you have the following:

> We understand that numerous intermediaries and investors are currently withholding funds from the municipal market because of the current uncertainties. When the New York City situation is resolved—one way or another—we can expect a substantial return of funds to the market, improving liquidity and lowering borrowing costs.

Mr. Simon, I have heard this again, when I heard very prominent people in this government saying, when there is enough unemployment it will cure inflation. Sure it will, if you have got anybody left. I don't think the Treasury Department ought to have a barber pole for its symbol which means bleeding the patient, and that is exactly what I see in this. There is a good deal of argument here about what kind of restraints ought to be put on municipalities. I notice that you said that submitting to Federal control, if we had Federal legislation, it will mean submitting to Federal control or pay the price of independence in the bond market.

Well, Mr. Simon, I was a mayor of a city and I had to submit to State control and I don't see a bit of difference between that and submitting to Federal control. In fact, I used to get a lot more help out of the Federal Government than I did out of the State. The State of New York has made it very clear it is going to impose controls on the city of New York, nor do I think that is wrong. You have been in this bonding business and brokerage business and banking business. I have never seen a banker yet that ever loaned you a dime that didn't want some controls on you. They either want all your collateral or they want to put a member on your board. When did that get to be such a bad practice, that the Federal Government has to have insured loans or guaranteed loans or a type of Reconstruction Finance Corporation loan or emergency loan? Of course there will be some restraints. That is exactly the way it ought to be.

I imagine that you, as a participant in the World Bank—and you are a big one—you have got 70 percent of the stock—I imagine that you insist upon some controls on loans, don't you? Isn't that right? Doesn't the World Bank—doesn't your governor on that bank insist upon some kind of organized control over the fiscal policies of the countries that are benefited by the World Bank?

Secretary SIMON. It depends on the type of loan. We have different criteria, depending on the loan.

Chairman HUMPHREY. Of course.

Secretary SIMON. The answer is "yes," and indeed there should be. I would like to respond——

Chairman HUMPHREY. All right. Wait a minute. Are you saying that this means that the little countries that are helped by the World

Bank are somehow or another having their sovereignty destroyed, that they have their independence destroyed? To the contrary. You have testified before committee after committee that this is sensible, prudent fiscal policy.

Secretary SIMON. But there is a difference between what the World Bank does, Mr. Chairman. The World Bank provides project loans for development and self-help in these countries.

Chairman HUMPHREY. Well, my good friend, it isn't so different. It is money. Money is money. It is just a question of whether you do it for the projects or whether you—and if you do it for projects, you don't have to then do so much for operating. Most of us have been around, you know, and we know that money is money.

Secretary SIMON. When you say there is no difference between State control and Federal control——

Chairman HUMPHREY. Not one bit.

Secretary SIMON. I think the Constitution says there is quite a difference.

Chairman HUMPHREY. There is no difference between when the controls are on, Mr. Simon—you never have been mayor of a city and I have. I can tell you a control is a control. I don't care whether it is wrapped in the Federal or State insignia. It is a control.

Now, what do you propose for this city except bankruptcy or default if the situation gets to a point where they cannot finance their bonds and where they cannot get operating funds? You heard the mayor of the city of New York here say he has got to borrow $1 billion before revenues come in, and what if they foreclose that?

Now, we had Mayor Alexander of Syracuse that came to us, bringing us from the Chase Manhattan Bank—we have got all the documentation presented here this morning. Chase Manhattan is a little bit bigger than the State Bank of Cokato and what does that release tell us? It says here from the Chase Manhattan—we have here:

> Investor confidence in New York State will be seriously impaired if the State underwrites city credit for the 2 to 3 years which may be needed to turn the corner. What we believe to be the only viable alternative is a temporary substitution of Federal credit for the city in order to insure the marketability of city debt until investor confidence is restored by a year or two of demonstrated performance.

That, now—that is Chase Manhattan. That is not some radical economist.

Now we come to Mudge, Rose, Guthrie & Alexander. And what do they say? Accordingly to my recollection:

> Bonds of New York city are the only municipal bonds that have been listed on the New York Exchange. Consequently I think that default by New York City would be the most serious default which could possibly happen to the municipal bond market and would adversely affect the municipal bond market in the entire country and would be particularly damaging to the State of New York and the municipalities and the other political subdivisions of New York State.

Now, those are just two and we had many here this morning that were given to us and I listened to all this business about the tax-exempt bonds and the bonds that are taxable and I find that our study reveals that that margain has been closing consistently, that there is—that the interest rates on so-called tax exempts is getting closer and closer to the interest rates on taxable bonds, and it has gone from 62 percent up to 75 percent. And, Mr. Secretary, as I listened to your testimony here today, and you are now going to have your time to respond, all I sense is that you have said that the administration will amend the Bankruptcy Act, first, and second, that you will take care of the banks. In other words, don't worry about the folks in the cities. We will take care of the banks. I have heard some of that stuff in my younger life and I didn't like it then and I like it less now.

And third, that default is a cure. That is right. A heart attack is a cure, too, you know, if you live through it, but sometimes they have medication that kind of tides you over and I would like to have your response to what I consider to be a totally negative presentation on the part of the administration.

Secretary SIMON. I hardly know where to begin, Mr. Chairman.

Chairman HUMPHREY. Well, begin with a proposal besides bankruptcy. That is no alternative.

Secretary SIMON. You cannot find either in direct statement or by implication that I stated or implied that default is a cure for New York City. On the contrary, I said that default can be avoided if the tough political steps, and I emphasized that several times, and they are tough political decisions, are made.

Having said that, I want to deal with something that is extremely important because it creates a great misunderstanding and the misunderstanding is already out there. Unfortunately, the level of economic literacy and financial literacy in this country is very low.

Chairman HUMPHREY. Now, Mr. Secretary, let me tell you something. I have no political benefits to get around here by supporting New York City. The city of Minneapolis has a good rating, and so does the city of St. Paul, and I am simply telling you that we want you to address yourself to the comments that have come from these mayors who bring in substantial evidence that says that if there is default, that it will have ramifications throughout the entire economy, and they present evidence. And secondly, that the bond interest rate is going up and that that chews up capital that is needed for the management of these cities. The interest rates seem not to bother this administration. You seem to sort of like it like MacDonald likes hamburgers.

Secretary SIMON. It didn't bother the Congress when I came up here 9 months ago and told you what was going to happen as far as interest rates, deficits——

Chairman HUMPHREY. It is no problem to go tell a man that he is sick. Tell him how to get cured.

Secretary SIMON. States and cities are paying more for their money. No doubt about that. But so are all borrowers. The municipalities don't live in splendid isolation from the consumer, the businessman, or anybody else.

Chairman HUMPHREY. Except it is tax exempt.

Secretary SIMON. It still is staying in relation. You state 62 percent and that was at the widest and shortest period of time.

Chairman HUMPHREY. In the past year, from 62 to 75 percent.

Secretary SIMON. All right. It fluctuates, depending on the volume of financing in the market at that time and it widens and narrows depending on the volume. The point is when we make the comparisons in the municipal market of a prime municipal versus the prime corporate, bearing the tax exempt securities, which is the only comparison, prime municipal versus prime corporate is 70 percent. Now, within the various rating categories, you are going to have, as I said at the outset of my testimony, certain large cities like New York, which finance an extraordinary amount that are certainly going to pay a higher interest cost. The supply is the issue. People demand a higher return, given the other concerns they have for the city. But I want to direct myself to something, Mr. Chairman, that you said about bailing out and this bailing out business is a phony issue because we did not bail out Franklin National.

Now, let me hasten to add what I am talking about and what our responsibility is.

Chairman HUMPHREY. Please explain that. That will be a dandy.

Secretary SIMON. Where the Federal Government's responsibility is—when a banking system or a major bank in the system is in trouble and what can happen as you well remember with a run on banks such as occurred back in the 1930's and must be prevented.

The Federal Reserve System provided loans, which is their function, to the Franklin National. Every one of these loans was collateralized by assets that were held in the Franklin National Bank. The purpose of providing these loans is to buy time for the Franklin National Bank to merge out of existence and to protect, most importantly, its depositors.

The equity—the shareholders of the Franklin National Bank didn't get a nickel. They lost all their money. I believe all their bondholders did, too. The Franklin was merged out of existence and the Federal Reserve actions saved the depositors from a potential loss of their deposits, even in excess of the FDIC insurance limit.

This is not a bailout. This is a function of the Federal Government, to protect the savings of the American people. We didn't protect Franklin National Bank.

Chairman HUMPHREY. I don't disagree. Except that you got more time to do it. That is all New York City is asking for, more time. There is no bailout.

Senator Javits.

Senator JAVITS. Thank you, Mr. Chairman.

Mr. Secretary, you sort of challenged the chairman a minute ago to find anything in which you sort of wished for a default upon New York and I charged myself that reading your letter to the chairman dated September 16—I read it that if there was default it would be practically wish fulfillment for you.

Now, I would like to read what I based that on—I will wait until you get it—you say in your letter of reply:

> As a result of widespread publicity, the Nation is fully aware of the financial situation in New York City and is particularly sensitive to the unique aspects of the situation, specifically the city's massive deficit spending.

Then you go on as follows:

> Given these levels of awareness, we do not believe that default would undermine fundamental confidence in our economy or cause financial institutions to adopt unnecessarily restrictive credit policies. Indeed, just the contrary may be true.

May I read that again: "Indeed, just the contrary may be true."

And it is at that conjunction in which I tried to read your mind and I respectfully submit that the remaining disjunctive, and that is what it is, "If the Federal Government were to act to prevent default" and so on doesn't change it. I read your mind as thinking it might in all cases be better if New York went bust than if it didn't.

Now, would you give me an answer?

Secretary SIMON. Yes, Senator Javits. I wish people would read my letters instead of my mind. I think if I honestly believed that, I think you know me well enough to know that I would have said that. Again, I did not imply that default was the best route for New York City to take. Over and over again through my testimony I have said I believe default is avoidable if the necessary steps are taken. I have said on occasion that it would be a tragedy if indeed New York City defaulted as far as its future borrowing problems are concerned and that it should avert default by making these tough decisions. There was no implication whatsoever, Senator Javits.

Senator JAVITS. Now, let me hear what are the tough decisions you want New York to make now. The mayor testified this morning and he said they had cut a billion dollars from the budget, laying off $400,000 worth of workers. That is what they got in salary. They had imposed the wage freeze. They had reduced union benefits. They had a 3-year expenditure ceiling put on them with a permitted flexibility of 2 percent. They had cut $32 million from the City University of New York's budget, equivalent to what it would get if it charged tuition. They had discontinued the practice of capitalizing expenses and they had placed practically a total freeze on new construction.

Now, those are what they have done, and I am too sophisticated, and so are you, to think that that is everything they can do, but I think as long as you have made this the cardinal basis of the Federal Government's case which you are writing, I want to hear your comments on these steps the city has taken.

So I ask you now—you say in your prepared statement at the very beginning, "Personally, I am confident that if the proper steps are taken, default will be avoided."

Well, I have read you the steps that have been taken. Now, what added steps do you propose that New York take to avoid default? And will you bear in mind, Mr. Secretary, that you know a lot more about this than most people, because you are a very competent man, quite apart from being Secretary of the Treasury. You actually did pretty well selling these very bonds for years to people all over the country as being a partner in one of our major banking firms.

Secretary SIMON. First of all, Senator Javits, it is not the responsibility of the Federal Government to identify what New York City should or must do to regain access to the financial markets. The requirements are the market's. What they have to do is present, first and foremost, which I am told they are going to on October 15, a credible budget that will describe to investors around the country and to the financial community, a plan—whether it is over 1, 2, or 3 years—that is going to balance the budget, that is going to stop the accounting gimmicks that they used for years, moving operating expenses into the capital budget where this year they have over $700 million of operating expenses in the capital budget, as you know. This is first and foremost and the most important requirement insofor as regaining access to the marketplace. And all of these things, because the budget isn't out yet, have not been presented.

Mayor Beame has appointed a very capable financial man to come in and run this effort for him, and I am confident that if these tough steps are taken—I would hasten to add more because I was asked at the beginning of this whole episode about 6 or 7 months ago what steps—I don't pretend to be a budget expert as far as New York City is concerned. But at this point you can just tick off the subway fare which obviously impacts on people. They raised the subway fare as of September 1. They have talked about tolls. And New York State obviously can assist to build this bridge that must be built until New York City again has access to investors all over the United States for its bonds. And this is what has to be done.

Senator JAVITS. Well, now, Mr. Secretary, the city has until November 30 to turn around. Suppose that the city does all the things it has done and more. No question about the track that it is on now. And there still is no market for its bonds. Do you have any other recommendation other than default?

Secretary SIMON. In my judgment, when we see happens on October 15 as far as the budget presented, and the investors' reaction to this plan, be it credible or not, which hopefully it is going to be, I remain optimistic that we wouldn't have to face that eventuality. But I wouldn't prejudge—I report, as the President ordered me to do, and monitor this New York situation as it affects all financial markets in the country. I heard one of the mayors complain about the interest rates that he is paying today, and he said—I believe he said in 1973—I paid this, and now I am paying this.

Well, all interest rates have gone up considerably since then, and they are almost at the peak and some of the cities, for different reasons, are paying more than the average prime well-run city. There are other cities that are paying a lower rate of interest today as a result of this flight to quality which really started at the Penn-Central bankruptcy. So, I must admit that, as I have said over and over again, if fiscal and financial credibility is restored by presenting a balanced budget, they will have access to the money marketplace.

Senator JAVITS. Well, Mr. Secretary, the United States guarantees some $83 billion in FHA mortgages, and the United States guarantees brokerage accounts up to $50,000 through an insurance company which has been organized for the purpose.

And the United States guarantees billions of dollars of savings banks deposits, and it offers hurricane insurance and it offers many other things.

Now, these are all last-resort propositions. Why not for the cities? Why are the cities the exception you cut out, to which absolutely flatly, inevitably, and irrevocably, the United States will offer no last-resort help whatever? Why?

Secretary SIMON. As I said in my testimony, Senator Javits, we would be creating a new security. Potential exposure would be $50 billion, $60 billion a year, because we must assume that would be the maximum amount that would come to the Federal Government for the privilege of borrowing with a Federal guarantee. That problem is the criteria. The problem is twofold.

One, the problem that I discussed with the chairman as far as what is the function of the Federal Government in telling States and local governments what their priorities are, whether they need a new city hall, whether they need a sewer system, when they could borrow, what their maturities will be, and to get in line and we will let you know when, indeed, if you can borrow.

As important, whether it is $20 billion or $50 or $60 billion a year, is what would be added onto already the enormous borrowing task that we have for the Federal Government. We would push up all interest rates further, because it is Treasury securities that are the benchmark for all interest rates. That set the level for all interest rates, and then the other interest rates trade around it because we do enjoy the greatest credit rating.

This hurts housing and small and medium-sized business. I would suggest that when they saw the criteria that the mayors and Governors would not wish to use this. They will say, we will have the quid pro quo, we will maintain our independence, and as a result, they want to go and finance in the traditional tax exempt way, without the Federal guarantee and maintain their independence and control over their fiscal affairs and they would pay a higher interest rate as a result.

Senator JAVITS. Well, Mr. Secretary, doesn't your last point blow your whole proposition out of the water? You say they won't come to you, so why do you talk about $60 billion?

Secretary SIMON. I am saying that there is a portion that won't come. The sum of $60 billion represents the total municipal debt in a year. Now, if $20 billion of them came, just add $20 billion federally guaranteed tax exempts, or whether it is $30 billion, and nobody knows what the amount would be, Senator Javits. Nobody knows.

Senator JAVITS. It would depend on the conditions you set, wouldn't it?

Secretary SIMON. I would imagine——

Senator JAVITS. None of us are asking you to just say any municipal can come and ask for a Government guarantee. In addition, the mayors have just forsworn in their testimony this morning tax exemption on anything guaranteed by the United States. Now, what do you base your $60 billion estimate on, which by the way, is still some $25 billion less than the FHA guarantees we write on housing which don't involve vast aggregations of people and municipalities?

But, even at that, what is your $60 billion composed of?

Secretary SIMON. It is composed of the notes and bonds that are financed by all the municipalities in the United States. As to the maximum——

Senator JAVITS. Every year, and you say now that all the municipalities will come to you.

Secretary SIMON. I didn't say that. I said that is the outside exposure and it might be 20. No one knows what the exact amount is, Senator.

Senator JAVITS. Suppose you set the condition that no municipality may come to you unless, in the first place, they just couldn't borrow funds in the open market at any price, like New York. Would that still be $60 billion?

Secretary SIMON. I believe, and this is again just a matter of judgment, that if we had a guarantee program, in a year many cities would come and seek the guarantee, seek the lower interest costs that would result in their borrowing. And that would mean that other cities would have to come because they would be under the political pressures that if so and so is rated the same thing, why aren't you taking advantage of this Federal Government program and borrowing and getting us a break on the interest rate, just as they are?

Senator JAVITS. As a matter of fact, Mr. Secretary, what other cities in the United States are close to New York in terms of default and why shouldn't they have the same right if they are that close?

Secretary SIMON. We would have to do it for every city and State, yes, Mr. Senator.

Senator JAVITS. Because I just ask you which are as close to default as New York. That is the condition I say you have to set.

Secretary SIMON. Our analysis doesn't show that any other city is in the condition that New York City is in, but do you honestly think realistically that legislation would pass in the Congress that would just deal with a city, rather than with any borrowing entity?

Senator JAVITS. Mr. Secretary, it will not deal with a city but will deal with qualifications of any city that will get that kind of help, and if New York is the only one that qualifies now, we are lucky. There may be others. That is what these mayors are all here about.

May I say this flinty attitude which is being displayed by the administration—I have got to charge it with that, because you are speaking for it—is very likely to bring on this action in Congress, because we just won't know where to turn and I believe the spirit is growing in the Congress against letting a great city, so thoroughly identified with the United States, go down the drain.

Secretary SIMON. I would hope, Senator Javits, and gentlemen on this committee, that you would, during these deliberations, consider very carefully the activity in the municipal bond market over the past 4 months. We find in our analysis no support for the proposition that other cities are paying usurious rates or even rates grossly disproportionate to prevailing rates in all sectors of our credit markets. I would like to submit for the record examples—the date that they sold, the interest cost that they paid—I think that that will substantiate my point. Fine. We do have some problems. We have an investor preference, and an investor demand today for disclosure of more financial information than they have ever asked for before because there is this fear, and I think that that is a healthy development. There is going to have to be more change. We are also, more importantly, going to have to change the structure of the municipal market. The municipal market has grown faster than the funds are available to invest in this market. We recommended a couple of years ago a taxable bond option where the mayor would have the option of tapping the taxable bond market.

Let me explain. Tax exempts appeal to just a certain category of investors. Pension funds, most insurance companies—many insurance companies do not require tax exemption. Pension funds are tax exempt already, but if they were taxable securities, given the same subsidy that cities and States enjoy through the tax exempt method right now, they would have access to broadening their market, and when these spreads widen and narrow, Senator Humphrey, as we were talking about a few minutes ago, they would have the option—go the taxable route and receive a subsidy from the Federal Government or go the tax exempt route, and your subsidy is built in. This maintains the independence of decisionmaking on the part of mayors and governors to say, I want to go to the market now, because we need a new school or new firehouse or a new sewer system. I don't want to go down and have to ask a bureaucrat when I can borrow and, indeed, if this is a priority—will he allow me to borrow for that purpose.

I think we have to look at this. We made, as I say, this proposal a couple of years ago, and it would greatly, in effect help the municipal bond market.

Chairman HUMPHREY. Do you still support that proposal?

Secretary SIMON. I have, yes.

Chairman HUMPHREY. Is that administration policy?

Secretary SIMON. That is not at present, because we haven't discussed it recently, but I presented that proposal to the Ways and Means Committee in March 1973.

Chairman HUMPHREY. Would you give us some idea of the amount of subsidy by the Treasury of the United States?

Secretary SIMON. We suggested at that time 30 percent.

Chairman HUMPHREY. I mean in dollars. Percent doesn't mean anything.

Secretary SIMON. Well, you can only make——

Chairman HUMPHREY. Thirty percent of $60 billion?

Secretary SIMON. Well, if you can only make judgments it would be on the long-term bonds only, and $60 is the total short and long and if—you can make a judgment on—first you have to figure what the interest rate is going to be, what type municipality would borrow. I wouldn't give a number, but we will give you the variables for the record, Mr. Chairman.

Chairman HUMPHREY. Senator Proxmire.

Senator PROXMIRE. Mr. Secretary, I have an open mind on this. I think you have made a very strong case, and I think the mayors made a very strong case. It seems to me it might be possible to design a program that would not have the catastrophic effect that you foresee for the kind of guarantee that you outline—or a direct loan that would still do the job. All of us agree we want to prevent a default on the part of New York or other cities. We all recognize, you do and we certainly do, the adverse effects this could have.

Now, you have a guaranteed program. You testified on that before my committee a few weeks ago. The guarantee of the Lockheed loan. The Treasury fought hard for that under Secretary Connally and President Nixon. I led the fight against it. We lost by one vote. You have that guarantee program. You have had it in effect for years. No other firms have been able to meet it. It didn't set a precedent the way I feared it would, although I opposed it, would like to see it reversed and, incidentally, when you appeared before us, you indicated that you might recommend it be continued in 1977. You also indicated if you had been voting in the Senate when that came up, you didn't know how you would go. You might go for it. So apparently it is no deep principle on your part.

Secretary SIMON. I think you know better than that, Senator Proxmire.

Senator PROXMIRE. Well, I am not so sure. You didn't say so. Will you say you will oppose the renewal of the Lockheed guarantee in 1977?

Secretary SIMON. No. I don't know what the circumstances are going to be in 1977. That law is there on the books and I have a responsibility under that law to carry out its mandate, but I will stay away from being rigid because I try not to be rigid and inflexible on any issue.

Senator PROXMIRE. Well, you are pretty rigid on this one.

Secretary SIMON. I am very opposed to any rescuing on the part of the Federal Government as a result of inefficiency in the private sector, just as you are, Senator Proxmire.

Senator PROXMIRE. Yes, sir. Well, now, let me get to the specific proposal made by the mayors. And it seems to me that it is quite different than the kind of guarantee that you indicated in your paper that you would oppose. You said that any form of financial assistance would directly increase the burden of the Federal Government and the burden the Federal Government imposes on capital markets.

Then you say that providing a guarantee of insurance for municipal debt would create a superior security, because it would have tax exemption and the Government—full faith of the Federal Government. And then you point out that it is very important that we have this threat of default to preserve the fiscal responsibility of the cities, and if we remove that threat, they may lose that sense of responsibility.

Now, it seems to me that we can meet all those conditions if we recognize what the mayors have suggested, and maybe strengthen it somewhat. Here is what they propose. As Senator Javits has said, abolish their tax exemption when they come in for the loan guarantee. Now, that would mean the Federal Government would make some money on this, compared to what we have now, because the obligations of New York City have a tax exemption now. The Federal Government would be able to tax those bonds and earn a substantial increase in revenue.

In the second place, I think it might be proper for us to consider an additional service charge. I think it might also be possible that we might consider an additional amount that might be modest, but nevertheless effective, in providing some kind of an insurance provision that would build up enough so that we could provide the protection, for instance, the FDIC does. After all, it was Andrew Mellon, Arthur Vandenberg, and Herbert Hoover who suggested that we insure Federal deposits, and at that time some people in the country, speaking as you speak now, said why—this will remove fiscal responsibility from the banks. The banks are the cornerstone of the free enterprise.

Well, we went ahead and provided it, and it has been a marvelous law. Everybody is for it. The most conservative Republicans say it is great. If you take that away from the bankers, they will really be unhappy.

Secretary SIMON. Also——

Senator PROXMIRE. Well, now, the mayors seem to be proposing something of that kind. It can be tailored to require perhaps a reasonable penalty or reasonable insurance premium, and it would not be something that would be so attractive to them that they would go to it, unless they absolutely had to.

What is wrong with that kind of modest, limited loan guarantee?

Secretary SIMON. We also tightened up during that period the regulatory process for the banking system, to make sure that it didn't remove a very important discipline. I am sure you agree with that. This seems to me, hearing it for the first time, that the taxable bond option that we proposed a couple of years ago, that I talked about a second ago, comes very close to that. It is a subsidy.

Senator PROXMIRE. I think that it does.

Secretary SIMON. And I don't know whether we can say that we make money, because it is substituting one subsidy for another than is already in existence, and if they don't want to use the market subsidy that exists in tax exempt, they would get the subsidy from the Federal Government to lower their interest rates while still maintaining their independence in the marketplace.

Senator PROXMIRE. Well, this sounds very interesting. Maybe I misunderstood you. You say you suggested years ago a taxable bond that would have a guarantee?

Secretary SIMON. Yes.

Senator PROXMIRE. I understood the objection the Treasury had to the——

Secretary SIMON. That was not——

Senator PROXMIRE. To the guarantee was you didn't want to guarantee a tax exempt. And I agree with that.

Secretary SIMON. That was not a guarantee. That was a taxable bond that would be subsidized to bring their interest rate down to what a tax exempt would give them.

Senator PROXMIRE. All right. Now, instead of that, supposing instead of the subsidy, you substantiate a guarantee. Why is that such an earth-shaking and radical, revolutionary proposal?

Secretary SIMON. Because——

Senator PROXMIRE. For our cities. We are not suggesting it for free enterprise. Just cities.

Secretary SIMON. Yes. I understand that, and all you are doing is adding on to the enormous borrowing requirements and transferring State and local borrowing requirements to the Federal Government, and you and I both know what criteria would be set, and they would have to get in line, just as the Treasury Department today acts as a traffic cop for our hundreds of agencies in their borrowings.

Sentor PROXMIRE. If I may say repectfully, Mr. Secretary, I am not suggesting that at all. What I am suggesting is that when a city is in an emergency situation, as New York is in now and as a few other cities may become, then we would be able to go the taxable route with a guarantee and with a payment of some kind of a premium that would provide a pool so that you would have the same thing you have in insuring anything else, a pool to protect the Federal Government. That payment could be made sufficient so that it wouldn't be misused. It could be adjusted. We have had lots of experience with that kind of instrument, haven't we?

Secretary SIMON. You can see the importance away from the discipline. We don't have to talk that anymore. That is like an insurance program.

Senator PROXMIRE. The disciplines would be there because they would have to pay this additional interest if they had to go that route.

Secretary SIMON. See, the problem——

Senator PROXMIRE. I agree with you. You have to have a discipline. I don't think we should give them something——

Secretary SIMON. Discipline remains when someone issues—they put in all the necessary criteria for this insurance or whatever program is, and they say, yes, this is the way we are going to live. They issue a 20-year security or a 30-year security and 2 years later you have a new administration in that city or that State and what control do we have to make sure that they maintain fiscal responsibility?

Senator PROXMIRE. Well, of course, we can't control what future Congresses do and we shouldn't.

Secretary SIMON. No; I am talking about——

Senator PROXMIRE. That is the way things operate.

Secretary SIMON. That is right.

Senator PROXMIRE. But, it seems to me we can provide the protection now and we have done that with the FDIC. That hasn't been eroded. That has continued at a high quality, high level protection for the Government. It hasn't lost a nickel. It has been a fine operation. You just championed it a few minutes ago.

Secretary SIMON. That is a constant regulation of a sector of our economy that should be regulated. We all had the experience where the depositors lost their money in the 1930's and that does protect the citizen.

Senator PROXMIRE. We are having a catastrophic experience now with people who may lose billions of dollars in municipal bonds.

Secretary SIMON. We aren't losing billions of dollars in bonds. I think we had better be a little bit careful in that. Let's talk about New York City, because that is all it is confined to. We already agreed that other States and cities are not going to be, at least I believe we have, are not going into default or are in danger of it as far as our analysis is concerned.

We show that under the present revenues all the other assistance programs are going to be continued to be paid. It is the notes that have the problem in New York City and that is going to require, if they went into default, some rescheduling just as occurs whenever any creditor has to declare a bankruptcy, and the legal provisions are established for him to gradually pay off his debt. It is not clear to me, because no one has any statistics on this, except that we know that the commercial banking system owns a large percentage of these notes and bonds, that individual investors who bought these notes are the ones in jeopardy.

Senator PROXMIRE. Finally, Mr. Secretary, how do you respond to the dilemma that we face with our constituents when they point out we make loans to the Egyptians, and Syrians and Chileans and Afghanistanians and people all over the world and we won't help out our own cities where our own taxpayers are suffering on an emergency basis, and with protections and limitations so that the Federal Government can be protected to a very considerable extent. How can you justify what seems to be such unfair policy for the American taxpayer who lives in the cities?

Secretary SIMON. Senator Proxmire, there is no doubt about that. It is the most difficult political and practical question that you can answer. How can I justify, when I sit here as the chief financial officer of these United States—it is my responsibility to say these things and justify the size of the Federal budget deficits and everything that we have been doing over the past 10 years. My only answer to that is what we are trying to do is correct the mistakes of the past and not look back.

Senator PROXMIRE. Mr. Secretary, the administration is proposing loans to these various countries I have listed. They proposed a loan to Egypt, a loan to the Syrians, a loan to the Chileans and Brazilians, and so forth.

Chairman HUMPHREY. And the Russians.

Senator PROXMIRE. They are proposing it right now. And they financed the wheat sale to the Russians with subsidized credit.

Secretary SIMON. Well, of course, at that time we had a surplus in the CCC program, which the Congress enacted.

Senator PROXMIRE. This time we have a catastrophe in our cities.

Secretary SIMON. We are not subsidizing the present sales. They are being sold at the market price today, the sales to the U.S.S.R. But we have learned that we don't live in an independent world. This word "interdependence" has become a very important part of our vocabulary. We learned a long time ago, in the 1930's the "beggar thy neighbor" tactics are counterproductive, and if we can help other countries to help themselves, this is indeed good for the U.S. economy as well.

Senator PROXMIRE. Why isn't it good, then, to help the New Yorkers and the Milwaukians and the Oshkosh people to help themselves?

Secretary SIMON. The point is we are just talking about New York, because Oshkosh and all the other cities, most of the other ones, while they are paying high interest rates, everybody in our economy is paying high interest rates, as the result of the inflation. What we are saying is that New York City must take the steps to restore its financial credibility and these steps have not visibly been taken to convince the investor community all over the United States that it is going to do the tough things that are required to be done.

Chairman HUMPHREY. Senator Percy.

Senator PERCY. I believe Senator Fannin was here ahead of me. I have a luncheon——

Senator FANNIN. You go ahead.

Senator PERCY. Thank you.

Mr. Secretary, I would like to, with Senator Javits' permission, tell you a story about when we were in Shanghai. The vice chairman of the Revolutionary Committee was sitting between the two of us. Senator Javits leaned over and said, "We have so much in common. You are the mayor of the largest city in the world and I am from New York City." The implication was the little city of Chicago was not really in the same ball park. I said, "No, Senator Javits, respectfully, I suggest the mayor of Shanghai and Mayor Daley and Chuck Percy have much more in common, because we are all from solvent cities, and you are the one verging on bankruptcy."

Chairman HUMPHREY. Might I add that Shanghai is a federally controlled city in China. [Laughter.]

There are two cities in China that have no local autonomy—Peking and Shanghai.

Senator PERCY. What we all have in common is boss-rule too. We have got a very strong boss and we have that kind of strength in the management of the city. Our expenses do not get out of line. With 49 votes out of 50 in the city council, Mayor Daley has been able to carry the budget through without too much trouble. And Senator Javits knows that I am not totally sympathetic with his position and attitude. I certainly supported, with other members of the Government Operations Committee, the counter-cyclical measure, which I hope will help cities and States in financial distress. But even it is nowhere near adequate to face up to this situation. I think New York City really has to go through what we are going through now in Illinois. We have to wring the pay raise for teachers out of the budget someplace. We are going after that area, and every conceivable area, including fraud which has been exposed in our welfare program, and we are wringing out millions and millions of dollars in every budget we conceivably can. I think New York obviously must do that and we can't be the bail-out point at the Federal level. It would be the signal to every city in the country to go ahead and spend and we will come in and bail you out. So, I feel the same way here I did about Lockheed. I voted resoundingly against it, and fought against it, and believe it was a very bad precedent, and I am concerned about this precedent. So, I am somewhat sympathetic with the position you have enunciated today.

However, there are some aspects of this that I would like to question you on. From your own background, Secretary Simon, and your experience in the New York financial community, you are well qualified to expand on municipal bond repercussions in the case of default.

Could you tell us what factors you did take into account that swung your opinion towards the view that the default will be tolerable? And can you analyze the facts on the positive side? Do you feel it has been fully discounted already in the financial community—this possibility?

Secretary SIMON. As I said several times during my testimony, this is a highly subjective judgment, and based on different conversation swith many people on Wall Street and around the country as to its effects on the nationwide market as well as the New York market. I also have people who disagree with me, and I don't say this with any certainty, as I said again many times. Obviously, we look at, first, the financial side and what happens when a city defaults. There is fear among the individual depositors, commercial banks, savings institutions, and those holders of city securities.

These fears must be allayed to avoid financial destruction, a fear that they are going to lose their deposits. The Federal Reserve will be providing liquidity, the FDIC and other regulatory agencies that will not require them to mark down the New York City securities for 6 months. If one thinks about it, the proposal to amend the bankruptcy law is quite important, because an orderly procedure can ensue, essential services will continue to be provided. Moneys that are left over are provided to the long-term debt holders.

The short note holders would, in some way, have to be rescheduled, or funds found to pay them off, or roll them over in the market.

Simultaneously, we must present a budget that is credible and accounting practices that in the future are going to be acceptable.

This is the financial side of the picture. This doesn't say, and I am the first to admit, (*a*) there has already been an impact on the markets. No one knows whether that impact is 40 percent, 60 percent or 80 percent of what the total impact will be. Markets always discount some percentage of a fear that exists among investors.

I believe that this market has done the same thing. Yes. I think there will be a further reaction if New York City did go into default. I believe that the measures that would be taken at that point would assure that this would be temporary.

That deals with the objective, the financial aspects.

Now, I will deal with the psychological, and I move into the area of the unknown, because no one knows that the psychology of the marketplace and the fear of the investors, the uncertainty, if that did occur. But I am suggesting that if people contained their comments instead of promising the American people a national economic disaster if a default did occur, that we sit back and take a little more measured view of the steps to be taken in an orderly way, to make sure that all of the debt holders of New York City are going to be paid, whether or not some of the short-debt holders had to be postponed for some time. New York City is not and will not be in bankruptcy. They have a revenue base that is strong. Their revenues have increased. They have Federal assistance that is quite large. They have State assistance also.

These revenues are going to be there. They are going to continue to be put into the city. And their problem has been that there has been about twice the growth of expenditures as growth revenues. After awhile, the ultimate arbiter just said no more, and that is the investor, the saver, in the United States, who said no more.

Now, if they bring those expenditures into line with the revenues that they can be assured of receiving in New York City, without further eroding their tax base, then this can be done in a very orderly fashion. What I am saying is they bought 3 months, and during this 3-month period, if they would take those steps and if more revenue is required, there are revenue-raising measures that New York State could do on an emergency basis, a 1-year or a 3-year revenue-raising measure that would provide this bridge over which New York City could return to the capital markets again.

Senator PERCY. But, it is pointed out that in the 1930's the Federal Government did step in and buy the bonds of certain municipalities. The Government bought bonds in the Buffalo Sewer Authority and bought Pennsylvania Turnpike bonds. Their doing so was a major stabilizing factor at that particular time.

It is pointed out by those who advocate your stepping in now that this provides a precedent. Could you comment on what differentiates New York from the situation of the Pennsylvania Turnpike and the Buffalo Sewer Authority and other municipalities from this particular situation?

Secretary SIMON. Well, of course, the Buffalo Sewer Authority—I don't remember whether that is secured fully by user-charges or not. I am pretty sure it is.

The Turnpike Authority is payable solely from the revenues on that turnpike, and they have to be much more than adequate debt coverage. People, investors, are going to remain confident that those bonds are going to continue to be paid off.

What has come into severe question here, and this was part of the mythology of the investment banking business, because the Constitution of New York says that the bondholders are going to be paid off, the debt service, principal and interest will be paid prior to essential services.

Well, if one sat back and said, well, in the real world, if really things got pretty tough, would that indeed occur? Would the policeman and fireman and sanitation workers be laid off? No, of course they would not be. An orderly process for repayment of the debt would occur. And that is what I am saying would happen in the event that that happened, and it doesn't have to happen, I hasten to add.

Senator PERCY. Mr. Secretary, finally, I think many of us who worked on the counter-cyclical bill, which is S. 1359, would like to know if the administration has adopted a position on it. Will the administration favor it as it comes before the House?

Secretary SIMON. We are still working on that right at the present, Senator Percy. The President is focusing on that. I expect you will hear shortly.

Senator PERCY. Thank you. Thank you, Mr. Chairman.

Chairman HUMPHREY. Senator Ribicoff.

Senator RIBICOFF. Thank you, Mr. Chairman.

I want to associate myself with the comments of the chairman and Senator Javits. I think what is very sad, when we sit here, and over a period of years, is to see the callous attitude of men in Government who have never been elected to public office talk about the problems affecting people. I think Senator Humphrey put it well. I think Senator Javits referred to it as flinty.

Now, you mentioned, Mr. Secretary, that New York is a unique problem. We had a group of mayors here, articulate, hardworking, subject to criticism and abuse from the people of their cities, and from people in public live and private life who all testified that there is nothing unique about New York, that the problems of New York are problems that they all share. These are large cities and small cities.

I have a clipping from the Bridgeport Post. The headline says: "New York City Fiscal Crisis Hurts Connecticut and Other States." And it goes on to point out that New York City's financial troubles already have cost Connecticut $1.7 million. In Oregon, 3,000 miles away, officials complain their State was slapped with higher than normal rates.

You mentioned Hartford, Conn. Hartford has floated bonds, has paid a considerable amount of additional money.

Now, I have before me an article from the September 22 issue of the Washington Post, entitled, "Will New York Spread Its Disease"?

Now, let me read—these are statistics taken by the Urban Institute and I found over many years they are pretty reliable statistics.

It costs three times as much per capita to pay for common city services, police, fire, sanitation, and general administrations of cities of more than a million people as it does in those of less than 50,000 people. Most big cities are old and that means their physical plants—streets, sewers, city buildings, and the like—are based on outmoded engineering principles. Maintenance costs are correspondingly higher than they would be in newly built suburbs, for instance.

Would you say that is factually correct, the cost in bigger cities as against smaller cities?

Secretary SIMON. I really am no expert on the finances of small versus large cities. I would imagine that the larger cities would have to provide many more services, so I am sure that their services would be larger in cost.

Senator RIBICOFF. So then the costs of the city would not be based just on debt management. Wouldn't that be correct? The cost the city has to bear to maintain itself?

Secretary SIMON. I think it is more relevant to compare the per capita cost of larger cities and that, of course, varies around this country a great deal, as I stated in my Rosenthal testimony, comparing New York City to all cities a million and above.

Senator RIBICOFF. Now, let me take another figure. New York, which suffered an out-migration of 464,000 people between 1970 and 1974, and has lost 471,000 jobs since 1969, and then against it you had a great in-migration form the South and Puerto Rico to cities like New York, lower-income people, not the middle-class, social services and welfare, what does that do to a city, the loss of jobs and the middle class, and the incoming of people on welfare? What does that do to a city, Mr. Simon?

Secretary SIMON. Of course, it raises the per capita costs. There is no doubt about that. New York City's per capita cost for welfare is $315 per capita. The next city to it is $20, and most large cities range from $1 to $5. Their costs are extraordinary.

That is the reason, Senator Ribicoff, that the President has asked Vice President Rockefeller to conduct a sweeping review of the Federal responsibility for welfare, and I have some very deep personal opinions on this. I think the Federal Government's responsibility in this area, to respond to the first part of your statement about the sensitivity to people, and I admit that any financial officer, any finance minister in any country, when he gets up and preaches what I call financial orthodoxy, he is going to naturally be accused of being insensitive and inhunane.

These problems that we talk about, however, aren't going to go away by throwing money at them and with more irresponsibility, that they are going to be exacerbated. The problems of the poor are going to be compounded, but we have to direct ourselves at the welfare problem in this country and take a serious look at an income maintenance program that guarantees an income to these people at the poverty level or close to it for people who cannot work for themselves.

Senator RIBICOFF. I am glad that you made that statement. Now, I am interested in what men like yourself and the Secretary of HEW and the President of the United States will do on welfare. I got involved in a fight for President Nixon's welfare program that lasted over 3 years and had the President and the administration walked out on that fight when he was looking for welfare reform because he did not want to face up to the political implications when you couldn't find a single Republican in the Senate and House that would take the Republican cudgels up for the Republican administration.

Now, welfare is important. New York City pays 25 percent of the welfare bill. There are 1,150 various agencies administering welfare. And we don't have a uniform system with standards and eligibility, but the problem is what will the President of the United States be willing to do to fight for it, because without the President of the United States being willing to fight for welfare reform, you are never going to get it.

Secretary SIMON. That is one——

Senator RIBICOFF. Now, the question is will President Ford be willing to fight for welfare reform and national standards?

Secretary SIMON. That is why the President has given Vice President Rockefeller, as a top priority, the welfare subject and he is starting with a first conference on this subject within a month, Senator Ribicoff, to be followed by others around the country.

Senator RIBICOFF. Are you personally for national standards?

Secretary SIMON. I would like a welfare program, as I said, that would guarantee the minimum wage with a very strong work ethic provided in it where people are just not going to receive a welfare check in lieu of finding work.

Senator RIBICOFF. All right. So any income maintenance would take a substantial amount of Federal dollars. Are you advocating or willing to advocate that the Federal Government assume the entire cost of that program as against the States and cities?

Secretary SIMON. Not at this point, until I see what all the figures are and also most importantly, I do not want to have a program like this that would go over and above all of the existing overlapping programs that we have now. This program would supersede those.

Senator RIBICOFF. Well, it is a very interesting thing. There are some 143 poverty programs, but the administration at that time wouldn't even present them to the Congress in the order of priority and willingness to eliminate some.

Now, let's get to another point. I read in the paper the last few days that the President has asked for the creation of a $100 billion Government-sponsored fund to encourage investments for the production of energy, because it is necessary for energy programs to infuse some public money.

Now, I happen to be sympathetic toward that approach. I am sympathetic for that approach because I recognize that there are certain basic issues that are so large that it is beyond the capacity of the private sector to handle.

Now, are you in favor of the President's program to create a $100 billion energy corporation, publicly sponsored?

Secretary SIMON. I am the President's representative. We have debates on many issues, Senator Ribicoff. People have their opinions, some strong, some not so strong, on every issue that is presented to him. After the debate is over, the President makes a decision, having weighed all the relevant merits of the arguments, and the discussion that he has heard. At that point, as a member of the team, all of us join in supporting the President's decision. That is what this democracy is all about.

Senator RIBICOFF. All right. And I agree with that position. So, when that is presented, you will come and testify in its behalf.

Now, that is done because energy is basic to the economy of our Nation.

Secretary SIMON. That is to provide—recognizing that this is of limited nature, this proposal of the President, it provides for the more sophisticated fuels: Solar, fission, fusion, oil shale, gasification and liquefaction. All of these methods today we know are uneconomic. We did a similar thing in World War II with the synthetic rubber experience, and I have testified before you gentlemen on many occasions that the Federal Government has a role where private enterprise, due to the fact that there is no profit incentive. Oil shale and those other methods I mentioned all cost more per barrel than they could sell it for.

Well, through several generations of technology and experience, as we did in the synthetic rubber experience, we can provide for turning this back, as this program would do, to private enterprise. This is not supplanting private enterprise. It is complementing it.

Senator RIBICOFF. All right. Now, don't you have the problems of the cities that Senator Javits and Senator Humphrey pointed out, that you have a city like New York and many others to follow where they have an infusion of the welfare and social responsibilities of the whole United States, as people pour into them at huge cost to the people of New York and out of New York pour the jobs and the middle class, and can a society socially, economically, and politically exist if there is a breakdown and destruction of the viability of the American city? So, in other words, if that is the case, isn't there a responsibility just as in energy to save the social and economic fabric of the United States, and all Senator Javits and Senator Humphrey and myself are asking for is to set up an institution or a method of guarantee and assure the existence and the viability of our cities, as you are doing for the big oil companies, with the $100 billion program which will guarantee and help finance them?

Secretary SIMON. Oh, yes.

Senator RIBICOFF. Am I correct in stating that that is what Senator Humphrey and Senator Javits are basically asking for?

Chairman HUMPHREY. Right.

Secretary SIMON. The point is you have to look at why jobs and why people have flown out of New York City in those numbers, because New York City has continued to live beyond its means. They have taxed where it is politically popular to tax, because they seem to be able to fool the people that by taxing corporations we are not taxing people. There is a silly notion that corporations are not people, that people don't work for corporations, that people don't pay for it through the goods and services the corporation produces. That is why New York City has, in the process, eroded its tax base, by continuing to raise taxes.

Senator RIBICOFF. Mr. Simon, I am not from New York City. That is not my State. But I reject that completely, because the march from the American city as it is from New York has taken place in every big city in America, and that is a basic problem. Whether it is St. Louis, Cleveland, Buffalo, Boston, Philadelphia, you have an out-migration of jobs and people, and an in migration of responsibility that the cities have to assume and absorb for the entire Nation.

Now, therefore, what bothers me the most is in your presentation, there is a callousness, and I don't say it is deliberate, there is a callousness when it comes to who do you support with money and with guarantees in help? You want to let the cities go to hell. The city is to be destroyed. And I can assure you if New York City goes down, it is going to have a fantastic impact on New Jersey and Connecticut and Westchester, everybody surrounding New York, and the ripple effect that it would have upon the country would be disastrous.

Secretary SIMON. That is just——

Senator RIBICOFF. You may comment.

Secretary SIMON. Senator Ribicoff, I just must admit that that is not true. We don't want New York City or anybody else to suffer when, indeed, the tragedy of a default is avoidable. And there is no observable evidence that Connecticut, which recently paid 5.59 percent for interest costs for its money in the marketplace—it has a good rating. It has handled its affairs properly and it is going to continue to have access to the capital markets just as all the other examples that I am presenting in the record. Over the last 4 months large amounts of money have been financed by 255 cities in many other States and they are paying reasonable rates of interest, compared to the other rates. All rates in the market are at too high a level, yes, but that is because of the extraordinary borrowing demands of the Federal Government and the terrible inflation that we have.

Senator RIBICOFF. May I add that the Treasurer of the State of Connecticut, Mr. Henry Parker, disagrees with you and he talks about the potential catastrophic fiscal problems that plague New York City and New York State, the effect it has had on the money markets concerning Connecticut, the additional cost to Connecticut, and the higher interest rates that Connecticut has to pay because of New York's problems. So the problem with New York does have an impact on the State of Connecticut.

Chairman HUMPHREY. Senator Fannin? Then that will be followed by Congresman Brown of Michigan. We have had some difficulty here because of the arrangements this morning as to who is in sequence here.

Senator FANNIN. Thank you, Mr. Chairman.

Mr. Secretary, I want to commend you for a very forthright statement. I never had the privilege of being the mayor of any city. I did serve a few terms as Governor of my State, and I had the responsibility of having a balanced budget. We still have that responsibility in the State. I hope we always will have. And I commend you for your expression of promoting fiscal responsibility, and I agree with you that it is very difficult for the Federal Government to save the New Yorkers from themselves. If they won't give the cooperation—I get to that a little later—that is necessary to solve the problem, it is very difficult for anyone to be of great assistance to them.

I didn't hear the full testimony of the mayors today, but I note there have been some sacrifices made in New York, and unfortunately those sacrifices have been consistent with the need, and certainly the sacrifices are necessary now because of what has happened in past years.

As you stated in your testimony, you are the Nation's chief financial officer and you have responsibilities to all the people, and I share your concern for the Nation as a whole, for the cities of our Nation, and certainly New York's default would be a tragedy for everyone involved. I think we all agree on that.

What concerns me more is the effect that Federal intervention in this particular municipal problem would have on the rest of the country. Now, I am talking about going further than what we are going to, because I feel the Federal Government is doing a great deal already. The budgets have been nonexistent, both at the Federal level as well as the State level, and the city level. Wouldn't you feel that the Federal guarantees of New York City's bonds only lessen the incentive to balance the budget of New York as well as of other cities?

Secretary SIMON. That would remove the discipline immediately and guarantee that they had access at preferential rates; yes, Senator.

Senator FANNIN. One I mentioned about New York, that it has not had the cooperation of the people, and just one segment of society, I think, is very much responsible for what is happening in New York, and that is the union officials. They have been living, I think, in a dreamworld, and their wage demands have been far beyond New York City's ability to pay, and under those conditions, bailing out New York City would encourage union leaders in other cities to grab for similar unrealistic increases. Would you agree?

Secretary SIMON. Yes, sir.

Senator FANNIN. This is of great concern to me. I feel we have serious problems throughout the Nation and certainly when we talk about other areas, we have had great growth in some areas of the Nation, which has created tremendous problems, and then cut back the economy and many cities would be in the same position as New York is in today. Yet, they have been just as careless when they handled their affairs. I think the Federal Government, to some extent, is responsible. I would say this, that what we have done in the welfare program and the way we have handled the welfare program I think has contributed somewhat to some of the problems of New York City. Would you agree with that?

Secretary SIMON. Well, of course, the share that New York City pays of the welfare burden is set by the State, not by the Federal Government. We have a 50-percent responsibility in New York State. New York State set New York City's payment themselves. We don't have anything to do with that.

Senator FANNIN. What I am, of course, referring to is some of the programs that have been expanded tremendously and expanded because the Federal Government has made it possible, and it is completely out of control in some instances.

Secretary SIMON. Yes, sir.

Senator FANNIN. Some of the social programs. And certainly, I realize the great need in the United States for social programs. But, I also am quite concerned about what we could do here at the Federal level.

Mr. Secretary, has your task force taken a detailed look at finances of other cities who are alleged to be in a deteriorating fiscal position? Have you had—you have heard the expressions of the mayors here, and you heard some of the cities that are having difficulties. Have you made any detailed study of that?

Secretary SIMON. I wouldn't say, Senator Fannin, that we have done a detailed study. We have observed very closely the borrowing experience of many of these large cities in recent times, the Clevelands and the Philadelphias, and the interest rates that they pay, and you know we have a Philadelphia issue which was high—I believe it was 8.8-percent interest rate—and one could say that is arguably disproportionate. But that doesn't support the proposition, because the bond market was very unsettled the week that Philadelphia came. It happened to be the day of a billion-dollar sale of Big MAC. And so they still have access to the market where they have their balanced budgets and where they have the data, the financial information that the investors now demand. This is something new, and it is something that is very healthy. Heretofore, it was just the accepted practice that where there were general obligations backed by the full faith and credit with ad valorem taxing power of a city or State, we didn't have to worry about it. Now, investors are beginning to take a second look at that notion and demanding that the States and municipalities, indeed, have a balanced budget and not one that is made up by deficit borrowing.

Senator FANNIN. Well, thank you, Mr. Secretary.

In your prepared statement, you bring out the possibility of New York City's default. Of course, we all regret what is happening, but as you brought out, it wouldn't be a total disaster if this did happen. I was really concerned, because with the projections that we have, and what is taking place—projections in the economy and what is taking place—I don't know whether the default could be avoided. I am not, certainly, capable of analyzing that to the extent that some of the other members of this committee would be, nor do I have the information that you would have, but it does seem to me that they face that problem and are not—they are just up against it for themselves, and have no alternative, that perhaps at a later date they might be in a better position from the standpoint of the municipal bonds if they do go through the procedure that is provided by the bankruptcy laws. I hope that isn't necessary, but in looking at their bond market, later on at least, what they are up against, if they keep carrying on as they are now and do not correct it, they are not going to have a good bond market, anyway, are they?

Secretary SIMON. That is the point, and while I don't hope they do, because I have seen what happens to municipalities after the 1930's that went into default, and several, indeed, did at that time, including some national names. Their access to the bond market, even when they restored financial credibility, was at a higher interest rate for many years. There are prudent man laws in some of the States, which say if a city or State or an entity has been in default, they must meet certain criteria, and a certain period of time must elapse to prove they indeed have financial responsibility before the issuer can borrow. These are all the things that militate in favor of making the decisions that have to be made anyway, as you said, Senator Fannin, right now, because if they did it right now and built this bridge, New York State and New York City, together, the city would find that it would have reaccess to the bond markets in a period of time.

Senator FANNIN. One of the great problems we have is if the city does fall back on the Federal Government, of course, we have legislation to provide for a Federal guarantee of municipal bonds. That has been advocated by George Meany, if I am not mistaken. And this is something that could be almost uncontrollable.

The big problem, as I see it, is if we start something like that, who makes the decision as to the amount of money that would be involved? Who makes the decision as to whether or not the money is being spent properly? And so when we are comparing what we have done in housing, for instance, through the FHA, and then say, look how much money we have spent on housing, and then say, well, couldn't we also feel that we have the same obligation to take care of the municipal bonds of the city of New York, it would seem we would be involved in the FHA procedures.

Isn't it true we had control of what was being spent, we had control of how it was spent? Isn't there a great difference between the two?

Secretary SIMON. Yes; there is, and also there is a big difference in setting as a priority a home for every American in this country. If that is deemed a necessary social purpose, that everybody should have access at, hopefully a reasonable price, to a home, fine. But, that has a big difference. That is day and night between the Federal Government taking over the fiscal, financial, political, and every other affair of State and local government.

Senator FANNIN. That is unless it applies to all.

Secretary SIMON. I think that has great social consequences, Senator Fannin.

Senator FANNIN. My time is up. Thank you very much.

Chairman HUMPHREY. My patient friend, Congressman Brown of Michigan.

Representative BROWN of Michigan. Thank you very much, Mr. Chairman.

Mr. Secretary, I feel as uneasy on this side of the table as probably you do as a New Yorker arguing against the cause of New York, but having——

Senator JAVITS. May I say, Congressman Brown, I really am sympathetic on that, but we are each doing what we have to do.

Representative BROWN of Michigan. But sitting on this side, Mr. Secretary, I would not want to let go unchallenged the suggestion of callousness on your part. I would suggest that exercise of a little more callousness by elected public officials might permit you to be a bit of a Populist and maybe display a little more compassion yourself.

The first time that we had direct contact with this matter as far as direct testimony was when Mayor Beame testified before our Government Operations Committee on the House side. At that time, he was very critical of the commercial banks because they weren't participating in the debt issues of New York. And in his statement before our Government Operations Committee, he especially alluded to and was highly critical of the meddling by commercial banks in the budgetary affairs of the city of New York, and he felt that that was not part of their business. But, he, at that time, suggested, as has been suggested today, the idea of a guarantee by the Federal Government, apparently assuming that any guarantee by the Federal Government would not involve any inspection or any budgetary surveillance as such.

I reject that. But I notice that in the Conference of Mayors' statement this morning that contrary to not wanting meddling, they apparently feel that in both the loan guarantee, under a loan guarantee program of emergency loan program, that, and I am quoting, "There would have to be evidence that revenues are sufficient to cover repayment. Although the grant of authority to the RFC"—the proposed Reconstruction Finance Corporation approach—"Although the grant of authority to the RFC by the legislation would be broad, it would be clear that balanced budgets, full faith and credit of the borrower and other criteria would be strictly enforced."

It is only in that context that all of the discussion of other guarantees by the Federal Government has any relevance. We have been talking about apples and pickles. The FHA—they conduct surveys, do inspections, for all intents and purposes, insofar as the quality of the loan is concerned, they are the lender. The FHA is the lender. The Lockheed guarantee was not a guarantee to a private corporation in a general way but, rather, under the Defense Production Act they had to be 90 percent involved in national defense, as I recall it, and so it was only the guaranteeing of a company to produce the instruments of our national defense.

Talk about FDIC of deposits. My God, I suppose New York City wants bank regulators there every year, or budget inspectors, I guess But, they don't want any meddling by just looking at budgets by commercial banks.

It is a fascinating way to ride both sides of that street.

I was interested in your analysis, which I think members of this committee should read again, where you basically point out, whether it be a guarantee program or direct loan program, the ripple, or I guess maybe you would say the 40-foot wave effect, of either of those programs upon borrowings of other municipal units, State or local. I mean, when you give a direct loan or guarantee to New York City, the next city down the line is bound to be impacted by the specialty program. So, his costs, that city's costs go up and they find that that—that city then finds itself in the stature of a New York.

Secretary SIMON. Could I interrupt for a moment?

Representative BROWN of Michigan. You certainly may.

Secretary SIMON. Because you are 100-percent correct, and that is sort of the dialog I was having with the chairman a little while ago. That is exactly what happens and that is when the mayor of that second city, who might have been managing his affairs just right and had good access to the market and maintained his freedom, he would be pressed by his constituents because he has to be elected, to go get a piece of that pie of the Federal Government and go down and get yourself a Federal guarantee so we can take advantage of x, y, z interest rate.

Do you know what has happened to the market today? Minneapolis, Minn., Mr. Chairman, is benefiting, yes, benefiting because of the problems in the capital markets. Why? Minneapolis, I believe, was still triple A the last time I looked.

Chairman HUMPHREY. It was when I was mayor, Mr. Secretary.

Secretary SIMON. Yes; and it still is.

Chairman HUMPHREY. I ran a tight budget and a tight city.

Representative BROWN of Michigan. It is too bad you didn't continue, Mr. Chairman.

Representative ROUSSELOT. Let's send him to New York City quick.

Secretary SIMON. Today when people are beginning to question, the flight to quality that started with Penn-Central's bankruptcy, gets exacerbated, and all the high quality paper that exists in the market, benefits by paying lower interest rates. Minneapolis and many other cities, thousands of other cities in this country, actually are benefiting as a result of that. I would hate to see that as a headline in the paper tomorrow morning, but that is what happens in the market. People who have credibility, financial, fiscal credibility in the marketplace are where people want to invest their money today, and the people who have run their business properly, the good mayors, of Minneapolis and the rest, Mr. Chairman.

Chairman HUMPHREY. I will come back to you. [Laughter.]

Representative BROWN of Michigan. You are alluding to the situation where New York City full faith and credit bonds, with the Federal guarantee, would be a better buy in the marketplace than Federal securities bothers me a bit. But, of course, they would be.

Secretary SIMON. Of course they would, and do you know what would happen then? I would hear from the mayor of Minneapolis. He would be down and would be saying why do you raise my interest rate? You want to take financial control because you are setting all this criteria for me to get the extra 1 percent, or whatever the subsidy is we are giving them. Can anybody argue that we take over the financial control of the city or State that we have taken over control over a lot more?

Representative BROWN of Michigan. Well, Mr. Secretary, that is the very point, that when you are attempting to relate or suggest that there is a parallel with the other guarantee programs we have, you have got to say that New York City is willing to have bank examiners, budget examiners, from the Federal Government in there every darn year, every budget period, in effect, writing the budget, or otherwise the suggestion that other guarantees apply just has no relevance, because these other programs are tightening, constricted, and are run by the Federal Government.

FHA is hardly writing any insurance anymore. Why? Because the private insurers are doing a much better job of processing paper and everything else, and nobody wants to give them FHA business.

We have people here on this panel who look at foreign assistance as an item as though the Federal guarantee to New York City would be, in effect, bringing foreign assistance, our assistance to other governments and projects, and so on, would bring it up into parallel. But, what about the Federal assistance that is presently not going to foreign countries, but is going to local units of State government, such as revenue sharing, medicare, medicaid, water, sewer, educational, community development, housing, ADC, and you name the rest?

Secretary SIMON. You know, we will give this fiscal year direct aid to States and cities of $60 billion, including revenue sharing, Congressman Brown. This doesn't include the total transfer payments which are up around $120 billion now, as well as other preferences, so we are extremely generous at the Federal level already.

Representative BROWN of Michigan. I would suggest also, Mr. Chairman, one other interesting point I think that Senator Proxmire brought up about the interest subsidy. I thought it was fascinating in connection with the joint conference last year on the Housing and Community Development Act that although many have been screaming about tax exempt bonds and we have got to get rid of them, these loopholes, and all that, and so we came up with the interest subsidy proposal so as to try to encourage State housing authorities and so on, to get away from going the tax exempt route and go the tax route and get the interest subsidy.

Well, if you go the tax exempt route for all of your housing projects, and so on, they are not subject to Davis-Bacon, but now, under an amendment that Senator Proxmire supported, and others, if you go the subsidy route, you have to go Davis-Bacon, and as a consequence, since most housing is not done under prevailing wage, you have nobody going the subsidy route, or very few, because they don't want to have that further impediment or that further cost, actually.

But finally, Mr. Secretary, and my time is up, do you feel that if we pass today some kind of a—I will use the term: It has been used—

bail-out for New York City, do you think that October 15 meeting there would be the budget austerity program that would be there if we don't do anything before October 15?

Secretary SIMON. No, I do not.

Representative BROWN of Michigan. Thank you, Mr. Chairman.

Chairman HUMPHREY. I don't think anybody needs to worry about this Congress doing much by October 15. [Laughter.]

I don't think that is our first problem, but I think it is a relevant point.

Congressman Rousselot.

Representative ROUSSELOT. Mr. Chairman, I am delighted to hear how well you did when you were mayor of Minneapolis.

Chairman HUMPHREY. I was good.

Representative ROUSSELOT. I think we ought to send you to New York.

Chairman HUMPHREY. I have thought about that. I have been trying to work my way up. [Laughter.]

We will put Bill Simon and Hubert Humphrey up there. Together, we would get it cleared up.

Secretary SIMON. We would make quite a pair.

Representative BROWN of Michigan. Mr. Chairman, if you promise to balance the budget of the Federal Government, I might even consider you for President.

Chairman HUMPHREY. That is a big order. [Laughter.]

You have loused it up so badly even I couldn't do that.

Representative ROUSSELOT. Mr. Chairman, we have a vote in the House, so I will have to be quick, but I want to compliment the Secretary of the Treasury. Unlike some of my colleagues, I think that you have been willing to come and tell us some of the things as financial officer of this country that more of us should hear. It is much easier to come here and give a lot of promises to people, we are going to do this or that, but I just hope we don't go through here what New York City is now going through on the basis of the way we are now spending.

I notice that Mayor Alioto did say that the Federal Government has caused a lot of the problems. He said it was because we made so many loans and everything to the suburbs, and all the highway money. But, I want you to know that I polled every single mayor in my district before this hearing, and not one of them believes that we should start a program of Federal guarantees to cities.

Now, these are admittedly smaller cities, but one of them. Pasadena, is a larger city. They said that the Conference of Mayors did not necessarily represent them here today. So, I want that on the record, because the impression was today that all mayors across the country want some kind of a guarantee and the reason they say that is that if we start this program, there will be no end to it, that every city, once it begins to have problems, it is much easier for the city council and the mayor to fluff it to the Federal Government, and we are already in deep trouble, as the Secretary knows, trying to finance a deficit this year created by this Congress that is going to run anywhere from $75 billion to $90 billion add-on deficit.

It has not improved unemployment, as we were told it would. It has not solved that problem. And so I think that you ought to be complimented for answering many of the hard questions that Congress itself does not want to answer.

Now, to what extent do you think that the—either the guanrantees or any grants to New York City or to other cities, and if we made it available for one, we would have to make it available for all, and there would be other cities in here—what effect would that have on the potential borrowing problem that we now have in the marketplace by the Treasury to either refinance our old debt that we have now, that now exceeds $500 billion, or any new debt that this Congress creates, what effect will that have on the marketplace if we add some more that we are going to have to finance or guarantee?

Secretary SIMON. Congressman, the answer to that is so obvious, because the problems that we warned about from the Treasury Department last January, February, and March have already arrived.

Our effect on the financial markets, on interest rates, on crowding out, on the ability of small- and medium-sized businesses to borrow, is enormous. We have squeezed all but the top priority borrower out of the marketplace. That is the small fellow. That is being inhumane, as far as the American people are concerned, because those who have the ability to borrow, usually the people better off, are the only ones that have access to the marketplace.

Representative ROUSSELOT. I appreciate your comment. I also appreciated your comments to several Senators who talked about this outflow to the suburbs, and to say that the increased tax policies have had no impact on that, of course, is false. It has had. And we always hang it on the corporations, and we think that they are not made up of people. Those are people that work, have to pay taxes, and the corporation then passes that cost on to the consumer. So it does affect the consumer. But we are not willing to admit that, somehow. We think it is magic.

I want to compliment you. I have to go vote on an amendment relating to the Panama Canal, and I do not want to miss that vote, but I do want to say that I appreciate your telling us that some of the comments that were made here today concerning the essential services. and none of us advocate default for New York City, but the essential services are basically guaranteed by the cash flow that most of these cities already have, certainly New York City, and unlike some of the testimony, these would not be shut off first. Is that your understanding?

Secretary SIMON. That is correct. It is the short note area that would be impacted and probably have to be rescheduled.

Representative ROUSSELOT. I appreciate your comments, and I want you to know all the mayors are not here saying absolute disaster will occur if we do not have some kind of a Federal guarantee program.

Thank you, Mr. Chairman, and I am glad to have you and Mr. Simon go up to New York and try to run it.

Chairman HUMPHREY. We will take care of that.

Secretary Simon, I just want to summarize here. I do appreciate your patience today and your willingness to stay for this long session, but this is a matter of grave concern, as you can see by the attendance here by this committee here today.

First of all, I want to compliment you on being able to get out such an attendance, particularly of the minority. They do very well.

Secretary SIMON. We worked hard on it.

Chairman HUMPHREY. But the majority turned out in pretty good numbers, too. This has been, too, one of our best hearings, with a certain amount of fire and heat and I hope some light.

I just want to run down—first of all, place in the record, for our purposes, the completeness of the record, table 6 of the tax-exempt and taxable yield ratios, to which I alluded and referred and to which you commented, from the municipal market developments and all pertinent provisions that related to it.

Also, a copy of the presentation by the mayor to President Ford today on the New York financial crisis, which lists some 11 measures which the city of New York has taken to put its house in order, and I might add, some very severe measures, which ought to be included in the record.

[The material follows:]

TABLE 6.—TAX-EXEMPT AND TAXABLE YIELD RATIOS

[Tax-exempt as a percent of taxable yield]

	Short term	Intermediate				Long			
		Aaa	Aa	A	Baa	Aaa	Aa	A	Baa
1974:									
September	50.7	....	57.6	61.0	50.0	64.6	63.4	61.8	....
October	51.6	55.1	54.9	54.0	55.3	66.0	66.0	66.6	....
November	50.3	59.4	58.4	55.5	54.4	71.1	70.4	68.0	....
December	49.4	....	66.0	58.1	....	69.9	72.4	74.3	....
1975:									
January	52.7	59.7	64.0	62.8	51.5	74.1	76.4	73.5	....
February	53.3	58.0	62.0	59.9	50.8	69.6	70.9	69.9	....
March	53.0	62.8	66.5	64.7	57.5	72.1	68.2	70.3	....
April	56.9	61.3	65.4	64.0	57.7	70.8	72.0	68.5	67.5
May	54.3	....	65.4	62.9	53.7	71.9	69.4	73.1	69.3
June	51.3	58.8	67.4	65.1	58.0	71.4	75.2	76.0	....
July	53.3	59.5	65.8	62.1	57.8	72.5	70.4	77.9	65.7
August	54.9	....	66.2	59.2	56.4	....	71.8	73.5	....
September	52.7	63.9	64.0	60.1	....	69.2	72.0	75.9	....
October	52.7	58.0	58.9	62.9	54.0	72.9	75.9	80.9	....

Note: A different method of calculating the taxable-tax exempt ratio of yields for intermediate issues is used for the 1st time in the publication. The intermediate yield for corporate and municipal offerings is the mean of yields for new issues during the month of reference. Shifts in the intermediate ratios from last month may in small part be due to the change in methodology for calculating the ratio; however the effect of this change is considered insignificant.

Sources: Short term: "Federal Reserve Bulletin, Bank of America Quote Sheet"; Intermediate: "Daily Bond Buyer," Rand & Co.—"Yields on Municipal Issues"; Long term: "Moody's Bond Survey."

Presentation to President Gerald Ford on New York City's Financial Crisis by Mayor Beame

STATUS OF NEW YORK CITY AND STATE FINANCING

Financial plan

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

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

Emergency control board

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

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

Timetable

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

MAJOR CHANGES IN NEW YORK CITY BUDGET AND MANAGEMENT

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

1. There has been a $1 billion cut in services in this year's budget, of which $400 million is due to layoffs.
2. There has been a wage freeze instituted for all employees.
3. There is a firm commitment to a ceiling on expenditures with no increases in taxes.
4. A new Mayor's Management Board has been established to recommend changes in the city's administrative process and to develop greater productivity. The board is composed of major corporate executives and chaired by Richard Shinn, president of Metropolitan Life Insurance.
5. A Temporary Commission on Long-Term Financing has been established by the mayor, composed of leading experts in urban policy and financing, to develop methods of financing for the city in the future.
6. There is underway a major reorganization of city agencies, including dismantling of the so-called super administrations, and in some cases the elimination of entire departments.
7. A new accounting system is being implemented to conform to the State controller's manual.
8. Items appearing in capital budget appropriations for operating expenses are being shifted back to the regular operating budget.
9. The Metropolitan Transit Authority has raised the fare to $0.50, more than a 43-percent increase.
10. Although the board of higher education has voted to retain a free tuition policy, the equivalent city tax levy funds for the City University has been cut $32 million by the mayor. An additional $32 million reduction takes place from State funds because the aid program has a matching requirement.
11. In addition, a new deputy major for fiscal affairs has been appointed by the mayor. Ken Axelson, vice president of J. C. Penney, has joined the city to develop the fiscal plan to be presented to the Emergency Financial Control Board and to be in charge of all fiscal matters for the mayor.

FUTURE FINANCING PROBLEM

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

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

Even if the City was compelled to default, and for the sake of discussion it had no adverse affect on the country's economy, New York would still have to finance necessary payments for minimum daily expenses for police, fire protection, education, health and other vital services. Therefore, the Federal government would be faced with the same decision after a default, as it faces today. Since there is at least the *possibility* that a default by the City and State will have an adverse economic effect on the nation's recovery program, and since the Federal government will in any case be faced with the same need for financial support for the City, it is logical and practical for such intervention at this time. Waiting until after a default by the City and possibly the State, would compound the overall problem and probably require a larger Federal role than would be necessary at this time. Clearly that was the case with the Penn Central, where bankruptcy not only *did not* solve their problems but required federal loan guarantees several months later. In addition, the Federal government is still supporting the financing of the rail system.

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

OUTLINE OF PROPOSED LOAN GUARANTEE LEGISLATION

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

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

2. In order to receive guarantees any City would have to meet several important criteria, including: (*a*) Nonavailability of credit from the private sector or from the State; (*b*) evidence that revenues are sufficient to cover repayment of principal and interest; (*c*) evidence that budgets will be balanced by real revenues for a number of years; (*d*) that only full faith and credit obligations would be eligible for guarantees. This would ensure that the Federal government would have first call on all revenues in the case of a default.

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

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

OUTLINE OF PROPOSED RECONSTRUCTION FINANCE CORPORATION (RFC)

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

Such an RFC bill should include the following points:

1. The program should be for all eligible cities and businesses and not limited just to assist New York City.

2. Such assistance should preferably be in the form of direct cash loans, at a favorable rate of interest, to the applicant. The Treasury Department seems opposed to guarantees of obligations because it would make Federal securities more difficult to market, which is particularly important when the Federal deficit is so large. It is felt that a direct cash loan would be less inflationary since the Treasury would be able to decide when to issue financing for the loan and could Spread the payments over a period of time more advantageous to the financing of the Federal debt.

3. The RFC might be given power to "tap" the Treasury Department, rather than creating its own "off the budget" fund. This would make all activities of

the RFC and individual loans subject to the Congressional appropriations process, thereby showing the Congress and the people just what the effort is costing. This would contrast greatly to back-door financing whose impact on fiscal matters is difficult to determine.

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

Chairman HUMPHREY. Much has been said about what New York City ought to do, but not enough has been said about what it has done.

I also include in the record, from the American Banker, the publication of the banking world, the article of September 22, 1975, entitled "Agencies Find 100 Banks Possible Problems If New York City Defaults: Ripple Effect Seen," and this article relates to the other commentary of Mr. Wille of the Federal Deposit Insurance Corporation, and he says in short, "What is worrisome to some regulators is the impact of a New York collapse on municipal securities markets in general and on banks that may be holding obligations of towns and cities that suffer from a ripple effect. My concern is not so much with the holdings of the New York City banks, but with the potential. "Regulators," he said, "generally feel the problem is containable, but they are still dealing with unknowns."

And then he went down to take note of the fact that in various parts of the country, the fact that banks in various parts of the country could be seriously affected, is one of the facts of the defaults of New York City's bond market for New York City bonds.

[The article follows:]

[From the American Banker, Sept. 22, 1975]

AGENCIES FIND 100 BANKS POSSIBLE PROBLEMS IF NYC DEFAULTS; RIPPLE EFFECT SEEN

(By Robert Dowling)

DURANGO, COLO.—About 100 small-to-medium-sized banks in various parts of the country could become potential regulatory problems if New York City defaults on its notes and bonds and an undetermined number could suffer from ripple effects, according to a confidential assessment of the impact of a New York collapse prepared by the government's three Federal banking agencies.

The assessment, which agencies prepared from examination reports, and in the case of the Federal Deposit Insurance Corp., from a survey last month of the 9,000 commercial and savings banks it regulates, formed the basis for Treasury Secretary William E. Simon's assurance to Congress last week that no major banks would be affected by a New York City default.

The Simon statement, contained in a letter to Sen. Hubert H. Humphrey, D., Minn., the chairman of the Joint Economic Committee; referred to "certain smaller banks that may face material capital reduction," but did not mention the number and wide geographical distribution of the banks that would be affected.

Details on the FDIC portion of the study were made known here Friday by Frank Wille, the agency's chairman, who told bankers attending a western regional FDIC meeting that his agency believes about 60 state-chartered banks that are not members of the Federal Reserve System could be seriously affected by a New York collapse.

Over-all, he said, Federal regulators now believe about 75% of the nation's banks fall in this category. That figure worked out to around 100 banks in all, FDIC officials pointed out.

* * * * * * *

To date, 8,089 banks of the 8,889 banks and savings banks surveyed have responded. Fifty-three of the banks have obligations exceeding half their capital and surplus. Twenty-five of those banks reported New York City notes and bonds total more than 70% of their capital, according to Paul M. Horvitz, the agency's research director.

While "not a trivial number of banks," the figures tend to discount previous undocumented statements that a large number of banks might be injured by a New York default, he pointed out.

More surprising, the agency official said, is the fact that banks holding New York City obligations generally are scattered around the country. He said this probably resulted because New York City obligations generally hold at higher yield than other municipal securities and thus, were attractive investments for many banks.

What is worrisome to some regulators, Mr. Wille said, is the impact of a New York collapse on the municipal securities market in general and on banks that may be holding obligations of towns and cities that suffer from a ripple effect.

"My concern is not so much with the holdings of New York City banks, but with the potential," he said.

Regulators, he said, generally feel the problem is containable, but are still dealing with unknowns.

He said the question was whether other municipalities might be unable to roll over debt in the event of a New York default and thus, find themselves in a default position too.

Banks as an industry are large holders of municipal securities. Regulators estimate bank holdings of municipals currently range between 12% of their assets and are equal to twice their capital.

The FDIC chairman said no regulator expects banks to take 100% loss on their New York holdings in the event of a collapse and that Federal banking agencies, like the Federal Reserve Board, are ready to step in to support banks if they get in trouble. He assured bankers attending the meeting, many of whom do not belong to the Federal Reserve, that they would be eligible for Fed loans, like member banks, if an emergency situation developed. He said there is "a clear understanding that the discount window" of the Fed will be "open for nonmember banks."

Federal regulators already have assured Congress banks can delay writing off their losses for six months in the event of a default, he pointed out, and he said they agreed with Mr. Simon's contention that no major bank would be seriously hurt by a New York collapse.

Congress until recently has tended to view the New York situation as an eastern problem and has shown little interest in backing proposals of New York lawmakers guaranteeing city's bonds or provide Federal help in other ways.

The fact that banks in various parts of the country could be seriously affected might change that.

FDIC officials said banks reporting large holdings of New York City obligations were in such areas as Texas, Florida and Missouri. They said some of the banks already were on their problem list, but this might be explained by the fact that they were banks that generally took greater risks in buying securities and other banking activities. They emphasized that the figures compiled by the agencies showed a maximum impact from a default, rather than an average.

They said there was no evidence so far that the banks were duped into buying New York City securities by sharp underwriters.

There is no question, however, that "a fairly good-sized number of relatively small banks around the country seem to have loaded up on New York City obligations," Mr. Wille observed.

Chairman HUMPHREY. Mr. Secretary, I would just want to call to your attention a matter which we would like to have your official view on. I introduced, some years ago, and have reintroduced again, what we call a proposal for a "National Domestic Development Bank" that would provide long-term financing of many municipal enterprises under strict bank rules. One of the things that I don't like about what we are contemplating here is that we, as a Congress, are attempting to deal with a specific matter that relates to banking. I think we ought to have in our Government a type of banking structure that can handle things like Penn-Central, like Lockheed, like New York City, so we can deal with it without this argument that we have here amongst those of us who are political officers of Government, and there is a need for such an institution. Even you, sir, are a political officer, because you are subject to the President's appointment and to the Senate's confirmation, and also, as you said quite properly, once the administration has arrived at a decision, your personal views have to be subordinated to what becomes the official policy, even though you may very well have expressed your personal views very effectively within the councils of Government. And I believe that had we adopted the proposal for a National Domestic Development Bank which would have done for our cities and our towns what the Federal Land Bank has done for American agriculture, which is all today owned, I may say, by the borrowers—the Federal Land Bank is no longer Government owned, it is owned by the borrowers—the "National Domestic Development Bank," in the same way, would be owned by the borrowers in due time, because of the use of that facility.

You have indicated that we have an interdependent world. Senator Javits, I think very properly pointed out that we have an interdependent country, and we have heard testimony here today, not from you, sir, but from others, that indicated that there is a great interdependence between cities and their relatively financial and fiscal structure and their fiscal and financial help.

Also, I cannot let this hearing come to an end without noting that many of these municipalities today, and counties and States, are having to lay off employees, cut back on budgets, raise property taxes, at the very time that this administration has advocated a tax reduction and rebates. The left hand doesn't seem to know what the right hand is doing. And then we wonder why fiscal policy in this country doesn't have the effect it ought to have in stimulating the economy.

All over this Nation there have been property tax increases. In many places, sales tax increases. Most every place, excise tax increases. And in a majority of the States, gasoline tax increases. At the very time that the Federal Government says that the way to stimulate the economy, and the President sends us down a message and the Secretary of the Treasury supports it, that the way to stimulate the economy is to have tax reduction. So we get tax reduction from Uncle Sam, and we get tax increase from Cousin Fred. And it just works in counterpoint, and somewhere along the line we have to do a better job, it seems to me, in this Federal system of ours, recognizing its difficulties, a total overall fiscal policy.

This is why we propose very strongly this countercyclical, antirecession proposal. Very important legislation. And I want to say, Mr. Secretary, there is no evidence as yet that the administration is doing anything but dragging its feet and most likely digging in against it.

I will be interested to see when the administration supports that proposal, because that is needed.

Now, it was said here by my colleagues, one of my colleagues, that essential services would not be cut off, and you agreed to this, if there was a default. I disagree with that. Either you are telling the truth or Mayor Beame is not telling the truth. Mayor Beame said if they could—that if they went into default, they would have to try to borrow $1 billion between November 30 and March, and they would not be able to get it, and if that is the case, New York City, for all practical purposes, would have to shut down, and I want to say that I think the consequences of that would be catastrophic. That is a word I will use in that context.

Secretary SIMON. Mr. Chairman, one thing. I would like to respond to some of the things you said, for the record, and I will, because I know you probably have to get to a vote also. But as far as the $1 billion that they have to borrow and the essential services are concerned, that is exactly why we have proposed the amendment to the Bankruptcy Law which presently does not provide the orderly procedure whereby a municipality, because they are not adequately covered, can handle the essential services. Our amendment is directed to providing the orderliness to insure that essential services can continue, indeed, without lawsuits and all the problems for the other creditors.

Chairman HUMPHREY. I understand what you propose, but really, if I may say, if the only solution that we have for the problem that is in this city of 8 million people is bankruptcy, then I think our policy is bankrupt. I think it is just plain bankrupt.

Secretary SIMON. As I said, Mr. Chairman, New York City is not and will not be in bankruptcy.

Chairman HUMPHREY. I don't think it will, but I mean the administration's program for the severity of the problem in New York City is to amend the Bankruptcy Law which, in substance merely says that the individuals can't be suing that you have to do it—there is some kind of collective class action, apparently.

Secretary SIMON. The problems of New York City, and the solutions to their problems, we believe rests in the city and the States themselves.

Chairman HUMPHREY. Well, we have a communication here from a very prominent authority up in New York that says that the State of New York can do no—can go no further. This is in the presentation made to the President today from the—according to Standard & Poor's—I think you have related to them today—it says:

> While it is the State's maneuver up to now to appear to be within its financial capabilities, any additional efforts most certainly will strain the State's resources, have a compromising effect on its fiscal integrity, and jeopardize its Double A high-grade credit rating.

Now, this is Standard & Poor's. It is simply saying that the State of New York has extended itself to the limit of its fiscal capabilities.

Now, these are things—maybe they are wrong.

Secretary SIMON. No. Let's define what they are talking about, because I don't disagree with that. All one has to do is take a look at the programs, as I related in my testimony, and the way New York State has gone about borrowing, again contravening the will of the people. When many States wish to borrow on a general obligation basis, they go to the voters and the voters say yea or nay, and most of the time the voters say nay, thank God, and in New York State, for years, when the voters voted against referendums, these moral obligation issues were set up and we saw a succession of those financial——

Chairman HUMPHREY. But those were done by the legislature, weren't they?

Secretary SIMON. Absolutely prepared by the legislature.

Chairman HUMPHREY. And who was in charge?

Secretary SIMON. And the problem——

Chairman HUMPHREY. Who was in charge? Not Mr. Beame, not——

Secretary SIMON. We are talking about, I am talking——

Chairman HUMPHREY. I am simply saying that the city of New York gets itself caught between——

Secretary SIMON. Wait a minute. I am talking about New York State.

Chairman HUMPHREY. But who was in charge of New York State?

Secretary SIMON. The Governor and the legislature are in charge.

Chairman HUMPHREY. Yes. Them, too.

Secretary SIMON. What happened, Standard & Poor's at that time dropped New York State's rating from triple A to double A, because of these financial shenanigans, and they say, all right, if you are going to continue to borrow on top of cash borrowings, we are going to drop it to single A, but that does not imply, and this is the point I was trying to get across, that New York State is not going to be able to borrow. It implies that due to the fact they are not running their financial affairs properly, they are not going to be rated along with the Minneapolises, if you will, of this world, in the higher category, the people who act prudently.

Chairman HUMPHREY. Well, I mean, I am not prepared to argue that case with you, except to state when Standard & Poors says New York State has now extended itself to the limits of its fiscal capability——

Secretary SIMON. To maintain its double A rating.

Chairman HUMPHREY. Well, not to maintain its double A rating. It says compromising effect on its fiscal integrity. I think that you have to take that into consideration.

Now, Mr. Secretary, we have had a long session here. We may have some questions that we want to send you. When you submitted your letter to me, I asked you for evaluations and analyses in detail as to your conclusions. We did not get that. I am sure members of your staff have that kind of detailed information that has brought you to the conclusion that you have. You have recited your views here, but I would like the analytical, the statistical material, because we are going to work on some legislation as individual members and——

Secretary SIMON. My staff——

Chairman HUMPHREY. I will ask the staff here of JEC to work with your people to see——

Secretary SIMON. Thank you.

Chairman HUMPHREY. If we can't get that information, and I don't intend to let this go by by saying that deficits are created by this Congress, and I remember one of my colleagues said, because I want you to keep this in mind, that he said, and you nodded your approval, that deficits created by this Congress have not improved unemployment and have not improved the economy. I have been reading these glowing reports from the administration that the economy is on the road to recovery and that unemployment has come down from 9.3 to 8.4 percent, and I might add that the deficit primarily is due to lack of revenue, and there isn't anybody that can deny that the main reason for the deficit is lack of revenue and cost of unemployment compensation due to the high unemployment, coupled with food stamps and welfare measures that accompany unemployment.

So we have got a double-whammy here. You have got low revenue intake and you have got high governmental cost, and this administration recommends the continuation and expansion of unemployment compensation. This administration sends us a budget here and it is bigger than anything we have ever had, before Congress ever tampers with it, and this administration that has preached the doctrine of fiscal responsibility has the largest deficit in peacetime history, and this administration that talks about the work ethic has more unemployed people than any time since the Great Depression.

So, I just think that the facts have got to be laid out, and that is what I am here to do, and I don't believe that once those facts are laid out, we can walk away from them. I think we have to get people employed and I don't believe it is fiscally responsible to let them sit on their tail and not be employed. And I think you have got to save a city like New York, even if it is difficult. It was difficult to save Britain at one time. We loaned her $5 billion. She didn't pay it back. And I am an internationalist, but I am getting damn sick and tired of the Government of the United States thinking it can save everybody else in the world, but when a community of over 8 million people, that no one denies is in trouble, and not only because of its mismanagement, when Eastern Airlines can bring people up from Puerto Rico every day by the shipload, you are going to have problems of welfare and economic problems in New York City for a period of time, at least. These people ultimately will get a job. They are fine people, but many of them come there poor and there are two cities in the United States that have welfare costs that are not picked up—Denver and the city of New York—and interestingly enough, the mayor of Denver is here backing up the mayor of New York. The mayor of San Leandro, Calif., a totally white suburb back here backing up the city of New York. The mayor of San Juan is here backing up the mayor of the city of New York.

These mayors are not in a cabal against the Government. I will tell you what they are. They are scared to death when they see 25 percent unemployment in Detroit, 14 percent unemployment in New York, 25 percent unemployment in Puerto Rico, and I will guarantee you when you see that, when you are a mayor of a city, you are not sitting behind that Executive Office Building, with those big iron gates up there. You are right out there with the folks. You talk about public officials that are threatened, you just be a mayor of a city, you are walking the streets. You are walking out there where the garbage isn't collected, and somebody starts to throw it.

So, Mr. Secretary, I just appeal to you to take a look at what Senator Proxmire talked about today.

By the way, we are going to present this legislation, and you had better get ready to present your official view. A taxable bond with a

Government guarantee, but no subsidy. I am surprised to hear the administration come out and advocate more subsidies in light of what I have heard in the past. An added interest treatment to insure security——

Secretary SIMON. This wasn't more subsidy. It was a shift of a subsidy from tax exempt to a taxable security.

Chairman HUMPHREY. It is out of the Federal Treasury.

Secretary SIMON. It is going to be out of it anyway, because the subsidy exists today. It is a shift which broadens the municipal market's ability to go to the taxable market.

Chairman HUMPHREY. Well, then, you ought to be supporting my "Domestic Development Bank," and I get you haven't studied it yet. I want you to take a look at it.

And then, third, a specific program where the city would have to submit a balanced budget with sound fiscal controls to protect the Government's guarantee.

Now, those are three basic features that are subject to alteration, tighten them up, make them more applicable, but just to stand here day after day, month after month, as the city of New York gets in greater trouble, and not only the city of New York but thousands of people who own those bonds, and to say that all we can do is tighten the belt and go bankrupt, to me is like saying arsenic and old lace.

Secretary SIMON. That isn't what we are saying. We are saying they don't have to go into default. They are not going into bankruptcy one way or another.

Chairman HUMPHREY. Bankruptcy or default. What is the difference?

Secretary SIMON. There is a big difference.

Chairman HUMPHREY. Is there?

Secretary SIMON. Why, of course there is. Bankruptcy implies we are not going to have essential services maintained, and New York City is, with an adequate change.

Chairman HUMPHREY. Well, now, you and the mayor had better get together. The mayor of that city, who has responsibility, said he has to borrow a billion dollars to maintain essential services.

Mr. Secretary, I just respect you greatly, but I also know Mayor Abe Beame, and I know the people he is working with. They have been down here to see us day after day, not just the mayor's people, the big-shot corporate directors.

By the way, all those banks up there that were buying all these bonds, and everything, they ought to know what they were buying. I am surprised that they were so ignorant. You say this situation has been developing for a long time, and it has been developing, but some of the greatest financial minds in the United States were concocting these schemes, supposedly, up there to take care of New York, and now they are going to put it all back together, and I don't think they can put it back together, and if I thought they could without our help, I would say no.

I would rather talk to you about what is happening in the Farmers Home Administration. That is a lousy outfit which isn't doing its job, and it ought to do its job, like the Federal Housing Administration ought to do its job, and the real reason it is not doing its job is because nobody has got them in the back room and said, I want that job done.

I knew something about running a city and a government, and somebody needs to take a good look at it and just call in these Cabinet officers and say, listen, we want some housing insurance here, housing loans, and figure out how to do it, and somebody ought to say to the administration people, people like yourself and others of great competence, figure out a way for a prudent and safe system to provide some protection to a municipality that may be going down the drain in default.

We cannot afford to let that happen. You know that.

Do you think that it is desirable or that it is acceptable to have a city go into default?

Secretary SIMON. We not only think it is undesirable, and unacceptable. We also think it is avoidable.

Chairman HUMPHREY. All right. You say it is avoidable. I won't deny that proposition, but if it isn't avoidable, what is your fail-safe program? I mean, if it is not avoidable, if things do go from bad to worse, and obviously New York City is not going through what you call a boom right now.

Secretary SIMON. They are not because the necessary actions haven't been taken.

Chairman HUMPHREY. Let's say they take more actions, Mr. Secretary.

Secretary SIMON. They are going to have to, whether sooner or later.

Chairman HUMPHREY. Then, what do you do before you call in the political morticians?

Secretary SIMON. You are not calling in a mortician. You are making it sound like New York City is going to disappear in a whirlpool in the East River, and that is not going to happen. The city is still going to function. The garbage is going to be collected.

Chairman HUMPHREY. Is it? Even when they had more garbage collectors, they had garbage around, and—listen, when you start laying off policemen, more police, more sanitation people, more firemen, and you start having trouble on those streets with an international center up there, with ambassadors running around, and what have you, I will guarantee this Government is going to take action and take it in a hurry, and it is going to cost twice as much. That is the system around this town. We don't do a thing that needs to be done until somebody is hurt so bad. I will tell you when we will do it, when the banks think they are really going to get it, when the big shots think they are really going to lose that money. That is when it will happen.

That is when we did something about kidnapping, when they kidnapped somebody's kid that was really important, and that is what is going to happen in this business.

When the little old schoolteacher who has got a tax-exempt payment—they say that is the market working its will. But, when it is the Hanover Trust or a big outfit, a big bank, I will guarantee Arthur Burns will say, break the waters, I am coming through. [Laughter.]

OK. Goodbye. [Applause.]

Before I close and without objection, I will place in the record a letter, with enclosures, from Evelyn Y. Davis, editor of Highlights and Lowlights of Annual Meetings, recommending cuts in New York City's budget.

[The letter, with enclosures, follows:]

HIGHLIGHTS AND LOWLIGHTS OF ANNUAL MEETINGS,
New York, N.Y., September 19, 1975.

Senator HUBERT HUMPHREY,
Chairman, Joint Economic Committee,
New Senate Office Building,
Washington, D.C.

DEAR SENATOR HUMPHREY: As the nation's leading minority stockholder as well as a New York City and New York State bondholder and a bondholder in some other state tax-exempts, I recommend that in case the City and State of New York do not make now permanent drastic cuts in their employees on the payrolls, eliminate free tuition at City University and rid the welfare rolls of ineligibles, default! That way they will have to make permanent cuts and, Senator Humphrey, many New Yorkers including myself are getting fed up with having to pay the highest income taxes (Federal, New York City and New York State) in the country without receiving anything in return for it, and to have our money given away indiscriminately.

When I speak of default I mean orderly default with Federal supervision. One has to make sure that the rights of bondholders are being protected and that the City of New York does not renege on its constitutional guarantee that the bondholders have a first right to "the full taxing power of the City". There have been talks that they are trying to pay off employees before bondholders against the New York Constitutional provisions. This the Federal Government will have to protect, the rights of existing bondholders who have received false and misleading information from the City of New York and the Banks and Underwriters as to the City's true financial condition! And this should not be a matter for the courts which will only mean a bonanza for the lawyers! Innocent parties such as the bondholders should be assured of getting their coupons paid and payment of the bonds at maturity at full face value! We bondholders are just as much "innocent" parties as are some of the smaller banks with paper losses. We bought our bonds in good face and now are faced with large paper losses. What is needed is new legislation to protect the buyers of municipal bonds the same way buyers of common stocks are protected by the SEC!

And Senator Humphrey I know the rest of the country at least many of our top corporate executives do not wish Federal Aid to New York City. (I have talked to some of them who are subscribers to Highlights and Lowlights, and Chairmen of the Board and Presidents, not flunkies). And they believe as I do that the worst that can happen is a short sell-off in the stockmarket and municipal bond market as well as temporary higher interest rates. Nothing worse than that. And Senator Humphrey I am writing to you as a New Yorker and a bondholder, but I realize that the good of the whole country comes ahead of New York, and that if New York were given aid now, they will never make those permanent cuts, and we the bondholders won't see it, but our money will be given away again and other cities will ask for aid, and then there never will be a stop to the staggering Federal deficit. . . . And also the Committee should protect existing bondholders as to having a senior claim to the debt, ahead of the MAC bondholders, who are trying to get some special privilege for themselves and are trying to get a guarantee for themselves ahead of those of us who have the five to fifteen year maturities. The Committee must see to it that we regular bondholders get our first claim ahead of he MAC bondholders.

Sincerely,

EVELYN Y. DAVIS, *Editor.*

Enclosures.

STATEMENT OF EVELYN Y. DAVIS

Gentlemen, I am speaking here today as a stockholder in 11 banks and 100 corporations. If CITICORP is allowed this floating note nonsense at 9.7 percent what is to prevent other Banks and/or Bank holding companies from coming out with another issue with even higher rates, say for instance 10.2 percent. A real price war would emerge and our banking system would then be in complete chaos. Just where will it end when will the bubble burst?

Small investors are being hoodwinked into believing that they are getting an insured deposit with no fluctuations. How many do read prospectuses and the fine print? The outflow of deposits from savings banks and savings and loan institutions into those notes can only result in higher mortgage rates and still more upward interest rates. A vicious circle with no end in sight. CITICORP must be desperate that it is letting the small investor in on a supposedly good deal. When CITICORP does something in the interest of small investors than it can only mean one thing: The big boys just don't want this supposedly great deal! And the small investor will be left holding the bag as usual.

It is about time that the Senate Banking Committee makes a complete audit and investigation of the banks that are coming out with that type of an issue. Is not one Franklin National Bank (and I am also a stockholder there) not more than enough for the economy to absorp. Also for bank stockholders this is not a good deal since these notes (which really are corporate bonds) do come ahead of our common stock.

What will happen if all investors at the same time want to get out of these issues? How well have the possibilities of these notes been researched when Citicorp Chairman Walter Wriston and Citicorp President William Spencer have been investors in the now bankrupt Home Stake Productions Company? They had the means at their disposal to investigate before investing? Why did they not?

The ones to benefit from these issues are not the small investors but besides the Banks, the brokerage houses and the underwriters such as the First Boston Corporation.

Certainly I personally as a sophisticated investor will not take anything out of a savings bank where I get a seven year guaranteed effective rate of 7.9 percent with FDIC insurance. . . . These notes and still higher interest rates may have further effects on an already down stock market. The whole monetary system and all regulations enacted in recent years are being circumvented and a stake. Will we have another 1929 or worse? Just where it will end? And when the commercial banks, savings banks and savings and loan associations dicker amongst themselves I do wish to bring to the attention of the Committee that in many instances commercial bank officers and/or directors are also directors of a savings bank or savings and loan institution. . . . What is needed is further federal regulations in the credit market.

STATEMENT OF EVELYN Y. DAVIS, EDITOR OF HIGHLIGHTS AND LOWLIGHTS OF ANNUAL MEETINGS, AT THE "WAGE FREEZE" HEARING HELD BY THE MAYOR OF NEW YORK CITY ON AUGUST 11, 1975

Mr. Mayor, my name is Evelyn Y. Davis, and I am editor of Highlights and Lowlights of Annual Meetings. I am known as the nation's leading minority stockholder and am speaking here today as a New York City Bond Holder. I am listed in Who's Who in America.

I am glad to see that you are instituting a "wage freeze." But for how long will it last and how good can it be unless you allow independent accountants to audit the City's books? And when are you going to take steps to reduce the City's payroll substantially, to eliminate ineligibles from the Welfare rolls and to make students pay for their tuition at City College?

As a bondholder I did not receive full disclosure as to the City's true financial condition at the time of purchase and I do wish to bring to your attention a front-page article in today's New York Times by Tom Goldstein as to comments made by an SEC Commissioner as to inadequate disclosure by the City. You stated that since March the City had been preparing a prospectus for bond and note issues. But what about private investors who bought their bonds before March 1975? And where is this prospectus now?

And you have said nothing about the private small investors. All you and the MAC Board seem to be concerned about are the Banks and the Unions. But remember, Mr. Mayor, the Banks are not the only creditors of the City of New York. There are thousands of small bondholders. And also you seem to care only about the short term notes that are coming due in a few months. What about those of us, Mr. Mayor, who have bonds with maturities from five to fifteen years? What assurances do we have that we will receive our semi-annual interest every six months and repayment in full of principal upon maturity?

All you and the MAC Board seem to be interested in is to receive help from the Treasury so you can pyramid the debt. You have not yet done anything to reduce expenditures. So far it has only been talk. A freeze is a good beginning, but it is not enough. I agree with Secretary of the Treasury, Bill Simon, that the City should not receive any Federal help but ought to reduce its expenditures. And with action, not with words, Mr. Mayor, and with independent accountants checking the results. And we cannot bear any higher taxes. I want you to know Mr. Mayor, I voted for you because I thought as a financial man you would be able to straighten things out. Do not let me down now.

[From the June 23, 1974, issue of the Washington Post]

Evelyn Y. Davis: Unhappy Gadfly's Limited Success

(By Deborah Sue Yeager)

"I WAS THE BLACK SHEEP OF THE FAMILY. BUT NOW I'M FAMOUS AND LISTED IN 'WHO'S WHO IN AMERICA' AND MY BROTHER IS JUST A DOCTOR ON THE WEST COAST"

Back in 1956, astrologist Jeanne Dixon told Eyelyn Y. Davis that one day she'd be a person of "national prominence" in a field dominated by men. Mrs. Davis—"Call me Evelyn, dollink"—feels the Dixon forecast has come true.

"When I left Washington 15 years ago, I was a nobody. Now I'm a nationally known figure," she says in her thick Dutch accent.

Mrs. Davis, now 44, is in a field populated by few persons, men or women. She is one of a handful of professional gadflies who torment corporate managers at annual stockholder meetings.

For the past decade, she has been attending the annual meetings of the almost 100 corporations in which she owns stock, and writes, publishes (and sells) a review of these meetings.

Though the gadfly season is over (it lasts from March through May), Mrs. Davis' critique of corporate behavior is on a 12-month cycle. Last week, in an interview in her room at the Mayflower Hotel here, she listed these areas of discontent:

The lack of minority representation on boards of directors.

The lack of adequate post annual-meeting reports with verbatim transcripts of proceedings identifying participants.

Political donations emanating from corporate coffers. She offered resolutions to proxy statements this year at General Motors, Westinghouse and DuPont, among others, to force pledges of "political non-partistanship."

Mrs. Davis has achieved limited success. Some companies have voluntarily curtailed tax deductible charitable donations, a move for which she claims credit, although Ralph Nader and others have also argued against such donations.

She was also effective in forcing Con Edison and Macy's to list the outside involvements of their directors in proxy statements. The move is intended to shed light on possible conflicts of interest.

Even if her goals have not been fully achieved, she has had an impact on the corporate mind.

Ford Motor Co., for example, was prepared for her arrival at its annual meeting last month in Detroit, aware of her penchant for publicity stunts. She has been known to arrive at meetings sporting red hot pants and New York Yankees tee-shirts. "I'm like an actress," she explains. "You need a costume to get attention."

Ford hired a uniformed female security guard to watch Mrs. Davis. But she managed to elude the guard and then climbed onto the stage during the meeting to hand chairman Henry Ford II a newspaper clipping as camera shutters clicked.

Once she gets the attention of corporate officers or the press, Mrs. Davis can deliver quite pointed critiques. She constantly refers to corporate officers below the rank of chairman or president as "flunkies." And, in last year's review, she wrote: "In our opinion, most of those female directors are just a bunch of jealous old bitches and would never agree to the viewpoints of a pretty woman stockholder!!!" Nevertheless, executives across the country, according to Mrs. Davis, subscribe to her 19-page "Highlights and Lowlights of Annual Meetings of Corporations" at $44 a copy, minimum order two copies.

Mrs. Davis began her unusual career in 1959, shortly after her first divorce left her with a few shares of stock. She moved from Washington (where she had attended George Washington University for two and one-half years) to New York, took short courses in securities and public speaking and then began her corporate pilgrimage.

Mrs. Davis, her recent attire more subdued, appears to have been influenced by Wilma J. Soss, a New Yorker who has been pressuring for the representation of women on boards of directors since 1947. But little love is lost between the two.

"A cause cannot choose all the people it draws to it," Mrs. Soss said in an apparent reference to Mrs. Davis during a recent telephone interview. Mrs. Davis calls Mrs. Soss a "has-been."

Despite the publicity she has received and her self-described "high-tax-bracket income," Mrs. Davis is restless. "I'm not what you call a happy person," she says. "Otherwise, I probably wouldn't do what I do."

In fact, Mrs. Davis seems fueled by her malcontent. "When I have nothing to do, I get depressed—the only thing that helps me is to keep busy and involved."

Even as a child, Mrs. Davis had to fight for recognition. "My brother was the favorite child. He became a doctor like my father," she says sadly. "I was the black sheep of the family."

"But," she says proudly, "now I'm famous and listed in 'Who's Who in America' and my brother is just a doctor on the West Coast."

After 15 years in New York City, Mrs. Davis is debating a return to Washington. She claims she needs new challenges. However, she acknowledges, some financial motives lie behind the proposed move.

"The unincorporated business tax in New York is a killer," she says, "and, with the difference in income taxes between New York and Washington, I can live like a queen here."

HIGHLIGHTS AND LOWLIGHTS OF 1975 ANNUAL MEETINGS OF CORPORATIONS---12TH ANNUAL REPORT

By Evelyn Y. Davis

FOREWORD BY THE EDITOR

1975 has been VERY interesting for corporation stockholders. Foremost has been the large percentage of votes FOR political contributions type of resolutions including those re-affirming political non-partisanship and disclosure of any contributions.

For the first time the subject of LEGAL FEES has been dealt with extensively. Most corporations (see page 7) WILL disclose these figures in response to questions. But will they rotate their outside counsel?

A dismal 1975 EUROPE with run-away inflation has been visited (page 8). 1975 Washington trying to recover from the Watergate area (see page 6) and New York in the midst of a financial crises have received special attention. (see LETTERS TO THE EDITOR).

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We do welcome comments from readers...

By Evelyn Y. Davis, Editor
HIGHLIGHTS AND LOWLIGHTS OF ANNUAL MEETINGS
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LETTERS TO THE EDITOR

Dear Evelyn:

In view of the precarious financial situation in New York City what measures should be taken in your opinion?

Signed: Government Official

Editor's Reply:

Many New York voters including myself had voted for Mayor Beame thinking that as a financial man he would be able to clean up the mess. Boy did we all get let-down!!!!!!!!!

City and State payrolls will have to be trimmed; students will have to pay for their education at City University, a wage and hiring freeze should be instituted. Non-essential services should be abolished and dollar a year men should disclose their dealings with the City and State.

Under no circumstances should the Banks allow the City to default on its obligations to bondholders.

In the press one only reads about the Banks and the Unions, nothing has been said sofar about the plight of the individual bond-holders, the small investors in the City (and State) tax-exempts!! They are just as much creditors as the Banks and INSIST on payment. That comes first; the protection of EXISTING bondholders!!!!!!!!!!

AND NO HIGHER TAXES.

FOR FULL DISCLOSURE:

Evelyn Y. Davis owns $15,000 in New York City Bonds with maturities from five to fifteen years..............

In the last election we also voted for a Republican President and a Democratic Governor. We vote the split ticket believing in the best man (or the lesser of two evils) at the time of the election!!!

Dear Evelyn:

You have properly identified the fundamental problem New York City faces: The scope and variety of services provided simply cost more than the City receives in revenues. Any real solution to the City's financial difficulties will require meaningful reductions in expenditures. You are also on target in suggesting that more or higher taxes is not an alternative. Such action would deter investment in the City and ultimately weaken its economic base.

Thank you for the copy of HIGHLIGHTS AND LOWLIGHTS. I enjoyed it.

Sincerely yours,
Bill Simon
(Secretary of the Treasury)

1975 WASHINGTON

1975 Washington deserves an A for effort to try to recoup from Watergate. The atmosphere is changing and one has to look to the future and forget about the past. Definitely SOME effort is being made to improve the lot of stockholders and taxpayers. We congratulate Treasury Secretary Bill Simon for his courage to present to the House Ways and Means Committee a proposal to pare corporate dividend taxes, as well as a proposal to permit individuals to put some of their income into savings tax-free!!!! It is about time that the double taxation on dividends ends and that savings should be encouraged!!!!!!

We also do approve of his tough stand on the New York City financial crises!!! After all if the Treasury were to help New York, other cities would follow and we might as well capitulate to socialism if that happened. But existing bondholders should be protected!!!!!!!

Most glamorous social event of 1975: The ABC-Columbia Pictures SPECIAL televised from the Kennedy Center and EVERYBODY was there including the President, the Cabinet, announced Presidential Candidates, Senators, Congressmen, local socialites and MOST of the Kennedys. Yes, Evelyn was impressed by THAT event. If nothing or NOBODY can impress one anymore then what is the meaning of life? Top Embassy shindig this year: Saudia Arabian reception for their visiting Finance Minister!! Most interesting people in D.C.? Those who leave something to the imagination!!!

Stockholder meetings attended by EYD in the D.C. area: Martin Marietta, Riggs, The Washington Post Company and Comsat. At Comsat Director Melvin Laird, a former Secretary of Defense stayed only a few minutes and then left. If he wishes to be a director of a public company he ought to learn to show some courtesy to stockholders and management!!!

We do hope that the Washington Star-News does not fold. Certainly there ought to be at least two competing newspapers in a market as important as Washington. Even if one does not agree with everything in a paper, the very nature of competition can make the other paper that much better. Competition and striving is what gives one the will to live, to go on and to excell!!!!!!!!!!!

We do note progress on the D.C. Subway System. Nice to be able to go from the Mayflower area to National Airport in less than 10 minutes or to Union Station in less than 5 minutes!! When is a good time to move away from New York City, or shall we say BROKE CITY? Perhaps after the 1976 elections when the air has cleared and the new administration comes in. Even, suppose President Ford gets re-elected you do not for one minute believe that he won't make changes in the Cabinet and the Regulatory Agencies? And of course, if the Democrats make it, changes will be even MORE drastic.

We do maintain our strict political neutrality. We find some things to agree and disagree with both Republicans and Democrats. Who cares whether a man is a Democrat or a Republican? As long as he is VERY, VERY important!!! Perhaps that is where our strength lies. In our total INDEPENDENCE. No one really knows how Evelyn stands on CERTAIN issues!!! Keep them guessing!!!!!

LEGAL FEES

In answer to questions put by Mrs. Davis at many annual meetings it was disclosed how exorbitant and unnecessary some of those "legal fees" really are!!! It is well-known that lawyers make business for other lawyers. Should not the auditors and the board of directors make a complete check of ALL financial dealings of corporate general counsels who are in a position to "farm out" hundreds of thousands or in many instances millions of legal business each year to several outside firms?

Could not a lesser-known firm do the same job for MUCH, much less. How much litigation can really be settled out-of-court in a friendly way? How much are corporate chairmen and presidents "intimidated" by lawyers who are trying to convince them that their services are necessary? Probably over half of all legal fees could be eliminated. Let law firms put in competitive bids instead of being chosen by the corporation's general counsel.

How much in legal fees are really disguised "political contributions" given to firms who do have politicians or ex-politicians as partners?

Many corporations unfortunately have lawyers on their boards who influence the choice of outside counsel (usually their OWN law firms). Generally, the more lawyers on the board the more legal fees!!!! Prime example: Travelers with seven lawyers on the board had 35MILLION in legal fees last year!!!! Some legal fees disclosed in response to questions at annual meetings:

A.T.T.	12.5Million	United Technologies	1.2Million
General Motors	11.5Million	General Foods	1.6Million
Ford	7.5Million	ABC	1.5Million
Exxon	5.2Million	Manufacturers Hanover	1.5Million
Con Edison	4 Million	Bankers Trust	1.2Million
Westinghouse	6.9Million	Gulf & Western	1.2Million
J.P. Morgan	6.5Million	Chemical N.Y.	1.3Million
Citicorp	5 Million	Washington Post Co.	1 Million
Warner Lambert	4.7Million	Norton Simon Inc	1 Million
Pfizer	4 Million	Martin Marietta	780,000
RCA	3.7Million	Loew's	550,000
Sperry Rand	3.4Million	Comsat	500,000
CBS	3 Million	American Shipbuilding	400,000
Chessie	2.4Million	N.Y. Times	300,000
Dupont	2.5Million	Riggs Bank	279,000
Time Inc.	1.8Million	Macy's	150,000

IBM and Chase REFUSED to give out their exorbitant legal fees!!!!!
Of the 35Million spent by Travelers $385,000 went to a Houston law firm of which a company director and former Governor John Connally are partners!!!

Norton Simon, Inc. CONCEDED to our PIONEER RESOLUTION as to the principle of rotation of legal firms (outside counsel) so therefore the resolution was withdrawn.

.....GREAT VICTORY HERE.....

THE CHANGING EUROPEAN SCENE

Europe compared to our 1966 and 1970 jaunts is UNBELIEVABLE to say the least!!! Really unless one has to go for business forget it!! RUN AWAY INFLATION is the order. If one went once years ago and had good impressions, let those memories linger unspoiled and untouched.

Strikes were everywhere. When EYD was in England the Channel and Irish ferryboats were out, a national railroad shutdown was THE talk and some airlines were not flying out of London. Evelyn met former Prime Minister Edward Heath on the plane and donated a copy of HIGHLIGHTS AND LOWLIGHTS. Believe you me, this man does need charity. A Britisher on the plane said he is now a "nothing". And the National Health Service does not work in England. Evelyn had to consult a doctor and since she wanted to see him the same day she had to pay plenty. British patients in the physician's waiting room said the same that in order to get prompt and good service one had to pay, although they were registered with National Health...It is another form of extra taxation for those who already pay the most in taxes.....

In Milano (and all over Italy) there was a hotel and restaurant strike. Instead of eating some "great" Italian food there was ONE pizza parlor open near the station and for tourists only. Even the first class reastaurant in the railroad station was closed. Really there are plenty of good restaurants in New York and Washington, and one does not have to worry about the water, salads and fruits. We did stock up in Europe on enterovioform, the famous anti-diarrhea drug which was taken off the market here in the U.S. How come a drug which can be obtained in many foreign countries without even a prescription was taken off the market by the FDA? Perhaps pressure from domestic competitors? Large campaign contributors have to be served!!!! One still has to look out for padded bills and watch one's change. Hotels in London start at $60-and in Paris at $80-. We recommend highly for business travelers to wear a money belt when in Europe, one large enough to hold credit cards as well. And please do leave the gold watch home!! Before entering a taxi DO ask for an estimated fare. Even on an expense account, does one want to be taken for an Idiot? At the table only accept unopened bottled water.

St. Moritz was a ghost town in the beginning of June, strictly off-season. The best way to see Europe and England if one feels one HAS to go is by first class Eurailpass and Britrailpass. Frequently the countryside hold more charm than the cities one already has seen. Remember if one has seen one castle, cathedral or garden, well the others are pretty much alike. When in London one ought to go though to Windsor Castle and to Stratford and perhaps Edinburgh if time permits. The scenery in Switzerland still outdoes anything else in Europe. In Germany one gets again the idea of unrest and run-away inflation.

Chairman and Presidents ought THEMSELVES to take a closer look at continuation of European business operations in those countries where labor has priced itself out of the market. Make your business trips UNANNOUNCED and find out for yourselves, do not leave those important business decisions up to flunkies who may have investments on the side in European (and other) supplier and consulting firms!!!!

DIRECTORS

Certainly great improvement has been made in attendance of directors at annual meetings, especially after we introduced the "absentee directors resolution." For instance, at CBS this year in New York only one absentee versus four at last year's Atlanta meeting.

Votes received on the requirement to make directors attend annual meetings mandatory were as follows: (Figures are approximate percentage of shares voting FOR resolution.)

Madison Fund	25 %
National Aviation	22.2%
Con Edison	22 %
General Public Utilities	13.8%
Bankers Trust	5.5%
CBS	3.1%

Unmarked proxies should not be counted automatically against resolutions. This cannot happen in a political election; why should this despicable practice be allowed in the corporate electorate? Lewis and John Gilbert did introduce some resolutions on this subject. EYD may use this proposal from time to time at some other corporations!!!!

The executive compensation resolution received less than 3% at J.C. Penney. Directors on their own ought to take the initiative and limit compensation!! Many corporations now do give out business and charitable affiliations of their directors in the proxy statement. We are only interested in the PRINCIPAL charitable affiliations. We do not care whether you are on the board of your church or synagogue's baseball team. We only play the MAJOR LEAGUES!!!!!

This resolution received 8.9% at FNMA, 3.5% at Loew's and over 3% at Alexander's!!

At I.T.T. a resolution to let officers retire at 65 was presented by the 68 year old Mr. Gilbert.

We do believe that once a director has retired from his own corporation he should no longer be on the board of directors of that corporation or any other company. Let his successor "inherit" those positions so that the company in question can still be represented on the various boards. Boards of Directors should not become senior citizen clubs, or retirement homes. By the way we do feel that those directors (over 65) could make valuable contributions in the whole area of gerontology and at THAT time ought to serve on the boards of charitable institutions, instead of giving their time during their employment by corporations, to those organizations.

CONDUCT OF THE MEETING AND ARRANGEMENTS

There is no better reason for the Treasury Department to completely cut ALL aid to the Penn Central and to nationalize perhaps the railroads than the despicable conduct of that meeting. No one else is THAT bad!!!!! At Chessie System the chairman tried to railroad the meeting through and stockholders received an UNWELCOME. This meeting was loaded with company stooges. The usual way one can recognize stooges: (1) They usually are there early, long before the meeting starts, (2) they sit near a microphone usually close to a speaking stockholder, (3) they usually leave before the meeting is over, after they have done their "dirty work" of attacking a speaker by stating "how long the meeting seems to be taken up by CERTAIN stockholders or that a "timelimit" ought to be imposed on speakers. (4) Invariably they are post-menopausal women or elderly impotent men usually ex-employees!!!

One jealous old bag at J.C. Penney admitted to EYD after interrupting her frequently that she had two sons working for the Company. (Well-reported in Woman's Wear Daily.) At General Foods the elderly stooge said he was from Coral Gables, Florida, right in God's Waiting Room!!!! Similar despicable characters tried to interrupt speakers at Exxon, CBS, GM, Westinghouse, IBM and a few other places. Frequently company lawyers or public relations jealous women train these dying vultures in what to say and when. Invariably their remarks are the same and they do say their "lines" when coached at certain times. They fool no on, including the experienced press!!!!! For what chairmen get paid they certainly can put up with questioners once a year. In spite of interruptions EYD came up with sensational answers to her questions at Exxon and GM. Evelyn's query at Exxon resulted in a Senate Investigation of the company's political contributions!! Could not happen to a company with any worse stockholder relations!!!

If General Motors chairman Tom Murphy wishes to impose time limits then let him do it impartially; the same goes for General Foods chairman Jim Ferguson (although these two meetings were improvements over last year). Walter Wriston, Citicorp chairman still lags behind his competitors. Stockholders were subjected to amateur searches before the meeting; women had to open their pocketbooks, but the woman director of Citicorp did not!!! This is discrimination!! No other corporation had such "security" measures. At Martin Marietta the question period was preceded with lengthy presentations by five divisional vice-presidents!! No other company does that!! Short presentations by the chairman or the chairman and president are the rule with MAXIMUM time set aside for the question periods...

Those companies who try to limit questions or allow others (mostly stooges) to interrupt speakers, perhaps they would like it better if Mrs. Davis speaks against them in Washington before Congressional or Regulatory Hearings?????? Take your choice!!!

Some well-conducted meetings included:

COMPANY	CHAIRMAN
ABC	Leonard Goldenson
American Shipbuilding	George Steinbrenner
Arlen Realty	Arthur Cohen
Bankers Trust	Alfred Brittain
Chase Manhattan	David Rockefeller

CONDUCT OF THE MEETING AND ARRANGEMENTS (CONTINUED)

COMPANY	CHAIRMAN
Chemical Bank	Donald Platten
Columbia Pictures	Leo Jaffe
Comsat	Joe McConnell
Con Edison	Chuck Luce
Dow Jones	Bill Kerby
Dupont	Irving Shapiro
Ford Motor	Henry Ford
Gulf & Western	Dave Judelson
IBM	Frank Cary
Loew's	Larry Tish
Macy's	Donald Smiley
Madison Square Garden	Alan Cohen
Manufacturers Hanover	Gabe Hauge
Martin Marietta	Donald Rauch
J.P. Morgan	Ellmore Patterson
National Aviation	Ted Walkowitz
New York Times	Punch Sulzberger
Norton Simon, Inc.	Dave Mahoney
Pfizer	Ed Pratt
Proctor & Gamble	Ed Harness
RCA	Bob Sarnoff
Riggs Bank	John Christie
Sperry Rand	Paul Lyet
Time, Inc.	Andrew Heiskell
Travelers	Morrison Beach
United Technologies	Harry Gray
Warner Lambert	Burke Giblin
Washington Post	Katharine Graham
Westinghouse	Bob Kirby

LOCATION AND TRAVEL

Pan Am and U.S. Steel met in San Francisco, UAL and A.T.T. in the Los Angeles area, Merrill Lynch in Seattle, GM and Ford in suburban Detroit, Chessie: White Sulphur Springs, American Express: Chicago, Martin Marietta: a Washington, D.C. suburb (near its new headquarters), GE: Boston, Great A&P: Kansas City, I.T.T.: Charlotte, N.C., IBM: Pittsburgh, Exxon: New Orleans, Xerox: Webster, N.Y., RJR: Winston-Salem.

American Shipbuilding met again in Lorain, Ohio. EYD had a resolution to rotate the meeting with 5.2% FOR. Since chairman George Steinbrenner promised to meet elsewhere beginning with 1976 this resolution won't be re-introduced!!

Merck met at a ridiculous spot: West Point, Penna. We hope Director Marian Heiskell will see to it that there is no further conflict between this meeting and the N.Y. Times of which she also is a director!!

Lewis and John Gilberg have attended many other annual meetings all over the country. The more stockholders go to the various meetings the better it is for all!!!!

POST MEETING REPORTS

Some fluctuations we find in this category each year. There is no set rule that a Company will remain on our EXCELLENT list or in the POOR category. Ideally all POOR would graduate to MEDIUM and then on to EXCELLENT and stay there!!! But sometimes they sink right back or spurt upwards suddenly to EXCELLENT!!!! For comparison read HIGHLIGHTS AND LOWLIGHTS OF 1974!!!!!

POOR reports included: Exxon, American Express, Bethlehem Steel, Continental Illinois, Pan Am, Standard Oil (California), Procter & Gamble and Time Inc.

CBS and Loew's this year slid back into the MEDIUM category because to many important questions were left out. Others in the MEDIUM category included: Litton, Boise, J.P. Morgan, Champion International, Great A&P, GAF, Merck, BankAmerica, Madison Fund, ABC, Campbell Soup, Macy's, Fedders, National Aviation, Fox, GE, UAL, OXY, MGM, Martin Marietta, Dupont, Liggett Group, Walter Kidde, Chessie, Citicorp, Gulf & Western and others.

It is still best to mention after a question the name of the shareholder. Some companies have at the end the names of all questioners without saying who asked what particular subject. We still put those corporations on our EXCELLENT list but in future years we may put them back into the MEDIUM category, in particular those that put undue emphasis on the questions of any particular shareholder!!!! The same goes for companies that send out transcripts on request!!!!!!

American Shipbuilding and the New York Times Co. for the first time on the EXCELLENT list properly included who asked what, as did Norton Simon, Inc. Warner Lambert, Merrill Lynch, Allied Chemical, Continental Corporation, Charter N.Y., Chemical Bank, and Pfizer.

Other EXCELLENTS included: Riggs National Bank, Travelers, United Technologies, Pacific Telephone, Bristol Myers, A.T.T., Johns Manville, Xerox, General Foods, Arlen Realty, Bankers Trust, General Public Utilities, AMF, Westinghouse, Chase Manhattan, Con Edison, RJR, U.S. Steel, Ford, GM, SCM, RCA, I.T.T., Kennecott, Columbia Pictures, Manufacturers Hanover, FNMA, Comsat, IBM, and a few others.

Exxon, (what do you expect) did NOT mention anywhere in its report sent to ALL shareholders a word about the sensational disclosures made at the annual meeting IN RESPONSE TO QUESTIONS ASKED BY MRS. DAVIS which resulted in a subsequent Senate Investigation about the Company's political contributions made in Italy and Canada!!!!!!!!

CHARITABLE AND POLITICAL CONTRIBUTIONS

Many so-called "charitable" gifts are really political donations, AND you better believe IT!!!! Charitable donations during 1975 included:

IBM	$25 Million	General Foods	$1.2Million
A.T.T.	19 Million	Travelers	1.1Million
Exxon	17 Million	Westinghouse	900,000
General Motors	13.8Million	Bankers Trust	800,000
Ford	13.5Million	Gulf & Western	715,000
P&G	3.4Million	Sperry Rand	675,000
Dupont	7.2Million	Macy's	583,000
Norton Simon, Inc.	2.8Million	Time, Inc.	525,000
J.C. Penney	2.8Million	Martin Marietta	520,000
BankAmerica	2.7Million	Con Edison	500,000
Citicorp	2.5Million	Pfizer	450,000
Chase Manhattan	2.4Million	ABC	375,000
RCA	2 Million	Chessie System	192,000
United Technologies	2 Million	Riggs Bank	166,000
CBS	1.8Million	American Shipbuilding	48,000
J.P. Morgan	1.5Million	Loew's	40,000
Warner Lambert	1.5Million	Comsat	40,000
Manufacturers Hanover	1.1Million	Columbia Pictures	38,000
		National Aviation	1,000

Resolutions to limit charitable contributions were presented at (%of shares voted FOR)

Gulf & Western	6.9%(74)	Ford Motor	2.56%	Also at Campbell Soup (74)
BankAmerica	8.7%(75)	Dupont	1.2 %	and Atlas Corp. (74)
Madison Square Garden	3.7%(74)	Pfizer	1.8 %	

Political non-partisanship resolutions were submitted by Mrs. Davis at:

Pan American	11 %	General Motors	4.2%	Chase Manhattan	3.1%
American Shipbuilding	7.6%	Madison Square Garden	3.8%	Westinghouse	8.4%
RCA	7.5%	Chemical N.Y.	3.3%	J.P. Morgan	2.6%
Columbia Pictures	6 %	United Technologies	3.5%	Manufacturers Hanover	5.6%
Chessie System	5.7%	Riggs Bank	2.5%	IBM	3.9%
Sperry Rand	2.5%	Travelers	3.1%	A.T.T.	6.6%
MGM	2 %	General Foods	3.3%	Merck	2.8%
				Citicorp	1.8%

Disclosure of political contributions resolutions were presented at:

GPU	12.2%	Xerox	3.8%
I.T.T.	7.8%	Pacific Telephone	Less than 3%
Continental Corporation	4 %	Campbell Soup	Less than 3%(74)
Exxon	3.7%		

As is usual with most resolutions: When a Company is not doing so well the % of votes FOR a resolution will go up. In those Corporations where a large amount of stock is held by insiders and/or institutions the percentage is usually lower. Also it is much better for stockholder to have as "inspectors of election" experienced bank tellers of publicly owned banks. They are far better equipped to perform this job, than to have this done by company employees or the corporation's law firm for instance. It is too easy for the latter ones to make "mistakes".

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THE 1975 PRESS

Is there such a thing as a really OBJECTIVE reporter, or are we all the products of conscious and subconscious pre-conceived notions and ideas about certain people and events? And are we not influenced by personal contacts? Certain writers still seem to limit themselves to interviewing certain shareholders while leaving out others. In all fairness should they not get viewpoints too from others than their "friends"? Is it surprising then when a competing paper scoops them completely?

During the 1975 season the N.Y. Times Sunday financial section definitely fell "into the cellar" of stockholder meeting reporting. We hope 1976 will be better. Financial editor Tom Mullaney did send some good reporters to a few of the meetings during the season including John Allan (Citicorp) and Agis Sepulkas (GM). Best reporting was done by a newcomer, Roy Reed (Exxon) and Peter Kilborn (Chase). Isadore Barmash had an interesting account of General Foods (which was cut out of the late city edition BY WHOM?????). N.Y. Times sports editor Jim Tuite and reporter Sam Goldpaper took note of the amusing side of the Madison Square Garden meeting. Times pictorial coverage continues to be poor; certain stockholders are included, while others are left out!!

Ahead during 1975 was the Wall Street Journal. N.Y. Editor Glynn Mapes had Scott Schmedel at meetings such as IBM, RCA, Xerox, I.T.T., Mary Bralove at United Brands, Tom Bray at Dupont, Mike Connors at CBS, Charles Camp at GM and Ed Foldessy at J.P. Morgan. Jim Tanner was at his best with Exxon. As everyone knows questions asked by Evelyn Y. Davis at Exxon re political contributions resulted in a SENATE INVESTIGATION of the Company....Sandy Jacobs had an interesting bit on the A.T.T. proxy statement which appeared in the Pacific and Midwest editions of the WSJ but which was edited out of the N.Y. edition. Lindley Clark had some interesting articles, specifically those dealing with the New York City crises.

Really moving ahead are the financial pages of the Washington Post. Financial editor Peter Silverman sent reporters such as Tom Jones, Claudia Levy and Terry Atlas to many stockholders meetings such as Riggs Bank, Martin Marietta, the Washington Post, Chessie System and I.T.T. In addition the Post covered many local D.C. area meetings. Stockholder meeting attendance in that area really has gone up and a large percentage of investors now live in the Washington area and suburban Virginia and Maryland communities. And remember MORE may move there especially with the situation in New York (BROKE CITY) getting worse and worse!!!! The Washington Star News (financial editor Tom Dimond) had Ron Snider at Martin Marietta. (see also page 6)

Best coverage of the Chemical Bank was by Newsday (George DeWan) and the Long Island Press (Tom McCarthy) who was also at Sperry Rand. Mike Hurwitz of the Press was at Madison Square Garden Corporation.

Pacific Telephone received note from Sid Allen (San Francisco Chronicle) and the San Francisco Herald Examiner.

THE 1975 PRESS (CONTINUED)

U.P.I. was at its best with CBS and GM including excellent pictorial coverage. (see page 3) A.P. had reporters at some out-of-town meetings.

Dan Adriacco and Alan Vonderhear gave color to the Procter & Gamble meeting for the Cincinnati Post and the Cincinnati Enquirer. The American Shipbuilding meeting received front-page notice from the Elyria-Chronicle (City Editor Joe Gluvna and Financial Editor Bill Rados) as well as from Jack LaVriha of the Lorain (Ohio) Journal. This same meeting was the subject of an excellent column in the Columbus Citizen Journal by George Roberts. They completely scooped the Cleveland newspapers as well as the Wall Street Journal (Ohio Bureau). The Cleveland papers seem only to be interested in the viewpoints of one stockholder!!!!!! Jack Markowitz scooped the competition at IBM for the Pittsburgh Post-Gazette!!! One of the best features ever done on Mrs. Davis was by Arthur Postal for the Baltimore News American. He scooped others on Evelyn's Baltimore Baseball Club stockownership!!! Merrill Lynch's meeting was attended by Michael Parks of the Seattle Times and Dan Coughlin of the Seattle Post Intelligence!!!

John Rumsey of the Rochester Times Union and a reporter from the Rochester Democrat noted questions asked by a representative of Lewis Gilbert at the Xerox meeting. Bob Murphy of the Hartford Courant landed the Travelers meeting on page one with disclosures on the exorbitant legal fees (see page 7). He and John Levesque of the Hartford Times were also at United Technologies!

Best coverage of A.T.T.'s Proxy Statement was by Columnist Stu Rose of the Trentonian, and by the Charlotte Observer. The latter paper was also at I.T.T., Ford and GM received attention from the Detroit Free Press (David Klement) and the Detroit News (Walter Smith). Wild and woolly Penn Central shenanigans were noted by Joe Newman of the Philadelphia Bulletin and Dominic Sama of the Philadelphia Inquirer. Don Glickstein was outstanding to say the least with this front-page coverage of Dupont in the Delaware State News!!!! Again a reporter who has NEVER been at a stockholder meeting and therefore CAN and IS completely unbiased!!!!!!!!! Best Campbell Soup story came from John Briggs of the Camden Courier Express! The Baltimore Sun (Bradley Martin) took note of the Chessie System as did the Newport News Times (Gene O'Bleness) and the Roanoke Times (George Kegley). RJR Industries' first home-base meeting was a major news event for the Winston-Salem Sentinel (Sid Bobst). Dupont's meeting was BIG news of course for the Wilmington Evening Journal and Morning News.

MAGAZINES, TRADE PAPERS AND OTHER PUBLICATIONS

On a Paris-New York plane ride Evelyn read a copy of People Magazine and found an excellent General Motors meeting story (see PICTORIAL PAGE). Fortune had a well-rounded charitable contributions article and Dun's Review had an annual meeting preview story as well as good coverage of the Gulf & Western meeting.

Advertising Age came to life in 1975 (keep it up) at CBS (Maurine Christopher), the N.Y. Times meeting (Fred Danzig) and Ford Motor noting Mrs. Davis' suggestion to get rid of the J. Walter Thompson ad agency.

THE 1975 PRESS (CONTINUED)

Investor Responsibility Research Center and the Council on Economic Priorities had extensive reviews of political contribution resolutions!!

Fairchild Publications reporters covered various meetings in their field. The VERY best was the review of the J.C. Penney meeting disclosing properly that the elderly post-menopausal stooge who hit EYD had two sons working for the Company. (See also CONDUCT OF THE MEETING)

Variety was asleep at most 1975 meetings' exception MGM!!

TELEVISION AND RADIO STATIONS

The Washington Post Hartford, Conn., TV station invited Evelyn to be its featured guest on the New England Journal Interview Program. EYD talked at length about the Travelers and United Technologies meetings in that city. ABC-TV Network broadcasted portions of the Travelers sensational meeting!!!!! (remember 35Million in Legal Fees were disclosed at that meeting). Ford and GM meetings could be seen at several Detroit area stations. The CBS documentary on the Rockefeller family this year (versus last year) left out the portion on the Chase Manhattan stockholder meeting. But CBS certainly had an hour long program about its woman director and her family glorifying themselves!!!!!! Can a woman officer or director stand it when a woman stockholder younger and prettier than herself gets some attention???? That is what companies can expect when they have women on the board - JEALOUSY!!!!!!! Evelyn was interviewed on New York Cable Television Channel D.

Several TV and radio stations carried portions of the Mayor of New York's hearings re the City's financial crises!!!!!!

Evelyn spoke at the Pace College Graduate School of Business Administration M.B.A. class on the subject of the "Corporation and Society."

1976 LIKELY ISSUES AND MISCELLANEOUS

Disclosure of legal fees, names of principal and other outside counsel is going to be a VERY lively 1976 topic!!!! "Consulting fees," relations with elected and appointed public officials (including dollar a year men), employment practices of executives "recommended" by politicians, legal political contributions made as well as other issues of particular interest in a presidential election year will be aired at many meetings!!!!!

Reduction in retirement ages, hiring of male secretaries (THIS will be of particular interest at a company where some vicious malicious secretary is too jealous to let her boss talk to a famous and glamorous woman!!!!!) Fuller disclosure of hiring of ex-government officials at ALL levels. Frequently some officials of regulatory agencies or other governmental departments rule in favor of corporations hoping to get some FAT corporate job or a job with one of the company's law firms!!!! Disclosure of INDIRECT political contributions. At Con Edison it was disclosed in answer to questions by Mrs. Davis that the New England Petroleum Company, of which the brother of New York Governor Carey is President received from 15 to 18% of the Company's fuel business!!!! It is any wonder they receive ALL those rate increases????????????????????? Management contracts of the Catfish Hunter type will be attacked! Changing and rotation of ad agencies. Use of sports or entertainment figures to endorse a Company's product. And auditors will come under more scrutiny as to their "independence!!!

The Banks in particular will be grilled as to their roles in helping to solve the New York crises. The Banks are NOT the "only" creditors of New York City (see page 5). And the bondholders have to come first in any possible default!!!! Time spent with some "charitable" organizations and money given to foundations which in return donate to politicians will be loaded queries of SOME meetings!!!!! One can be sure 1976 is going to be unforgettable, and it won't just be politicians who make headlines!!!!

Evelyn Y. Davis from time to time does support some of the resolutions presented by Lewis Gilbert and Wilma Soss, as well as proposals made by others. At other times we do support management against proposals with which we do not agree as for instance the "South African withdrawal" proposition. Let the corporations stay there!!!!!!!! Mrs. Davis is completely independent, and NOT associated with anyone. Strictly a POWER (and she is going to get more and more) in her own right!!! AND YOU BETTER BELIEVE IT!!!!!!!!!!!!!!!!!!!!!!!!!!!

PROBABLE DATES OF SOME 1976 ANNUAL MEETINGS

January	Baltimore Baseball Club	10S	April	Riggs Bank	4S
January	Loew's	75S	April	Manufacturers Hanover	32S
January	MGM	55S	April	RJR Industries	20S
January	American Shipbuilding	21S	April	CBS	20S
March	Johns Manville	10S	April	CPC International	10S
March	General Public Utilities	20S	April	Martin Marietta	10S
March	Pacific Telephone	50S	April	General Dynamics	10S
March	BankAmerica	20S	April	Bethlehem Steel	10S
March	National Aviation	199S	April	GAF	10S
March	Dow Jones	10S	May	The Washington Post	30S
March	Madison Fund	16S	May	City Investing	40S
March	Citicorp	40S	May	U.S. Steel	12S
March	Chase Manhattan	22S	May	RCA	16S
March	Chemical N.Y.	16S	May	Pan American	20S
March	J.P. Morgan	20S	May	Comsat	25S
March	Continental Corporation	10S	May	Kennecott	30S
March	Continental Illinois	20S	May	Champion International	20S
March	Charter N.Y.	10S	May	Ford Motor	19S
March	Travelers	20S	May	General Motors	19S
March	Bankers Trust	11S	May	Xerox	50S
April	Dupont	4S	May	I.T.T.	20S
April	Merck	20S	May	Con Edison $3000-GG	30S
April	Bristol Myers	10S	May	J.C. Penney	10S
April	Pfizer	90S	May	ABC	74S
April	Warner Lambert	80S	May	Fox	20S
April	American Express	30S	May	McDonald's	60S
April	Allied Chemical	10S	May	Baxter Labs	30S
April	Potomac Electric Power	50S	May	Standard Oil (Calif.)	10S
April	IBM	12S	May	Exxon	10S
April	General Electric	10S	May	FNMA	40S
April	Westinghouse	20S	June	Great A&P	10S
April	American Telephone	40S	July	Arlen Realty	10S
April	AMF	12S	July	General Foods	20S
April	Time Inc.	15S	July	Sperry Rand	10S
April	UAL	20S	October	Procter & Gamble	10S
April	N.Y. Times	30S	October	SCM	30S
April	Merrill Lynch	10S	November	Macy's	20S
April	United Technologies	10S	November	Alexander's	11S
April	Hyatt	75S	November	Norton Simon Inc.	18S
April	Boise Cascade	13S	November	Campbell Soup	10S
April	Republic Steel	10S	November	Gulf & Western	100S
April	Walter Kidde	6S	November	Madison Square Garden	30S
April	Chessie System	20S	December	Penn Central	20S
April	Liggett Group	20S	December	Fedders	40S
April	United Brands	50S	December	Columbia Pictures	22S
April	Occidental Petroleum	50S	December	Litton	54S

See also page 5 (LETTERS TO THE EDITOR) for disclosure of Mrs. Davis' holdings in New York City tax-exempt bonds.

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Chairman HUMPHREY. The committee stands adjourned.

[Whereupon, at 1:55 p.m., the committee adjourned, subject to the call of the Chair.]

NEW YORK CITY'S ECONOMIC CRISIS

WEDNESDAY, OCTOBER 8, 1975

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to notice, at 9:40 a.m., in room 1318, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senators Humphrey, Proxmire, Javits, Percy, and Taft; and Representatives Reuss, Moorhead, Hamilton, Long, and Heckler.

Also present: John R. Stark, executive director; John R. Karlik, Loughlin F. McHugh, Courtenay M. Slater, William A. Cox, Lucy A. Falcone, Robert D. Hamrin, Jerry J. Jasinowski, and L. Douglas Lee, professional staff members; Michael J. Runde, administrative assistant; George D. Krumbhaar, Jr., minority counsel; and M. Catherine Miller, minority economist.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Chairman HUMPHREY. The committee will come to order.

Chairman Burns, we thank you very much for joining us. I would like to open our hearing with a statement about the problem as I see it. We are very grateful to you for sharing with us today your views and observations on the current fiscal crisis in New York City.

The subject of today's hearing is probably one of the most complex that we have confronted and surely one of the most complex I have confronted in my many years of public service. Even the most distinguished experts have heretofore been unable or unwilling to clearly and substantively identify the scope of the problem. In fact, every possible public solution, including the do-nothing alternative, carries with it great risks and undetermined liabilities.

In conducting a public hearing today, I must admit that we are walking down an uncomfortably thin line. On the one side, we have a very real need for Congress and the Nation to be better informed of the real financial and economic consequences of a default. Good information is the foundation upon which good legislation is built, so there is a clear purpose in separating fact from fallacy. On the other side, however, we have enormously sensitive capital markets and financial institutions that will react swiftly and actively to many of the words that are uttered here today. We simply cannot ignore the responsibility that this sensitivity imposes upon us. For this reason, we must exercise great caution and avoid creating an atmosphere which guarantees the occurrence of precisely those events that we are seeking to avoid.

With this caveat in mind, I feel compelled to express some of my own personal concerns about this important issue.

The subject of today's hearing is undoubtedly one whose significance extends far beyond the boundaries of New York City and New York State. To be sure, the 8 million Americans who reside within the boundaries of the city will be most directly affected. Even without default they face significant cutbacks in services, freezes on employee wages, and work force reductions which will undoubtedly have a severe impact on the regional economy. However, with default, even in the best of worlds, the consequences for the city would be unfathomable.

To compound these hardships, the State is now involved in the finances of the city. Any further developments that affect the city's finances adversely will greatly jeopardize the State's ability to obtain financing in the capital markets even for its own purposes. It must be made clear that the State will have to borrow up to $4 billion for legitimate purposes and functions by June 1976, a feat which would be enormously difficult should the city default, further increasing the skepticism about any security with the name New York on it.

But the problems are not confined to New York City and New York State. Yields in the municipal bond market have soared to unprecedented high levels. Interest rates as high as 10 percent, a heretofore unbelievable level, have been paid by several cities. These cities are not bad credit risks. They do not have huge operating deficits. They are not financing operating expenditures with capital borrowings. Yet their only alternative to accepting these usurious interest rates is default.

We had a panel of 13 mayors testify 2 weeks ago before the committee in support of Federal aid to New York City. The mayors could easily have said, this is a New York problem and we don't want to get involved." But they realized very early that such a policy would be penny-wise and dollar-foolish. It wasn't any great affection for New York City that precipitated their supportive testimony, but a clear appreciation of the fact that the uncertainty caused by New York's financial crisis was costing all of them millions of dollars—not just this year but for many years to come.

And, as you have already stated, Mr. Burns, the financial crisis now confronting New York City could seriously undermine the recovery that is currently occurring in the national economy. Banks could be forced to pay more to obtain capital, which will cause interest rates to rise. Caution will be exercised by lending institutions until their equity capital is rebuilt. Investment decisions could be altered significantly if disruptions occur in the equity and capital markets. As you are well aware, Mr. Burns, the last thing that we need right now as we try to keep the economic recovery strong—are higher interest rates and a retrenchment of lending activity.

We have even seen the first examples of international concern about the city's financial crisis. Last week Helmut Schmidt, Chancellor of West Germany, warned of an international domino effect should New York City be allowed to default. Yesterday, the New York Times contained an article which cited quotations from several international economic experts warning of the international repercussions of a default. To quote just one, Christopher Gruebles, a director of the Union Bank of Switzerland, "We feel that default would seriously affect capital markets and might also affect the dollar. The currency pattern has already been blurred."

I do not cite these quotations to scare people or to create chaos in our capital markets. Rather, like any other public official, I am deeply concerned about the enormous amount of uncertainty which we confront as we deal with this issue. Concerns have been expressed by many and later repudiated by some—but neither the concerns nor the repudiations carry with them substantive and supportive analysis.

Even with this uncertainty, however, I frankly see no constructive purpose that can be served by default. Certainly the city needs to achieve significant economies, but these are being achieved now and will continue to occur even in the absence of default. Without a doubt, the debt of the city will have to be restructured, but this too is being accomplished through MAC and could be completed with Federal aid. Even the overhaul of the city's bureaucracy can best be accomplished without the incredible disruption and law suits that would inevitably accompany default.

Since I strongly believe that all of these goals can best be accomplished through an orderly transition rather than a default, I intend to introduce legislation tomorrow that will insure a reasonable scaling down of the city's financial problems and allow an orderly return to private financing. I will present this legislation tomorrow in testimony before Senator William Proxmire's Banking, Housing, and Urban Affairs Committee.

Mr. Burns, as I said, we appreciate your willingness to appear here and to share the expert analysis of yourself and your staff and the informed opinions of yourself and the Board of Governors. I assure you that any counsel you provide us and you give to the Congress and the Nation on this complex matter will be listened to attentively and considered carefully.

Senator JAVITS. Mr. Chairman, I join the Chair in my satisfaction in having so eminent an authority appear before us. And Mr. Burns will have a part in what ever is done, even if it starts in the Congress, which I now feel is our only resort. I get no satisfaction whatever from the President nor from the Secretary of the Treasury. I think that is most deplorable, but it is a fact.

The fact is that by some appropriate response to the New York crisis, we could fend off an economic explosion. If we don't act in time, we could have such an explosion almost as extreme as this country has ever known. Millions of other financially depressed cities would have almost no choice other than to go bankrupt too. If investors realized that the Federal Government was going to turn a deaf ear to the problem of obtaining marketability of municipal securities, billions of dollars in construction by State and local governments all over the country would be likely to be halted with the inevitable disastrous effects on unemployment. And unemployment in the construction industry is already at 20 percent. And we would have a disastrous effect on the progress of our economic recovery.

And we have heard from other Government leaders and bankers about these effects. Our own Treasury Secretary seems to refuse to tell us that the New York City situation presents important national and international and financial risks, to which Senator Humphrey has just alluded, which demand a response from the Federal Government.

The situation would be less urgent if New York had any room to maneuver, but in fact, it does not. New York City has instituted a wage freeze and laid off some 21,000 municipal workers with 20 more thousand layoffs to come. It has raised transit fares materially to 50 cents a ride and initiated a major reorganization of city agencies. It is implementing a new accounting system and correcting admitted abuses of the old one. It has given up to the State of New York many fiscal powers it previously exercised. If will shortly be submitting a fiscal plan designed to bring the New York City budget into full balance in 3 years.

New York State has advanced or loaned the city more than $1 billion. In so doing, it has exceeded itself to the point where its own fiscal integrity may have been jeopardized.

My own personal experience with New York, and it has been lifelong, convinces me that they will take these cutbacks and other hardships in stride. For example, I recently joined with other political leaders in my State and city to invite a group of outstanding New Yorkers to give of their time and expertise to a "Citizens Committee", and not one turned me down. They are extremely busy men and women. And this citizens committee has already had an encouraging amount of momentum behind it.

I think also we see signs of conciliation on the part of the municipal employee unions, which by the way have taken an undue amount of blame in recent months themselves. But the Federal element is lacking. Unless Washington acts—and I'm delighted to hear Senator Humprey's announcement of Senator Proxmire's hearings and Congressman Reuss's announcement—unless Washington acts, we run the grave and incalculable risk of a loss of confidence in our Federal system.

For New York, the world should know, is being asked to keep within its ancient political boundaries as to self-financing, but yet to accept at the same time, the bulk of the migration of several millions of people, largely from the South, following the civil rights revolution. And yet again, to get no emergency Federal help.

I think that is just unjust, Mr. Chairman, and it moreover, can't be done. What we have is not just the potential bankruptcy for a city, but the loss of faith by people throughout the United States and the world in the fiscal integrity of government. The time has passed for wagging fingers and hunting around for scapegoats. The time has also clearly passed for wishing the problem away. With so much at stake, we cannot afford to argue about whether the market can or cannot absorb the New York City default. The risk is just too great. Only Federal action at this time can, in my view, set matters right and give us enough breathing space to restore fiscal sanity to our beleaguered State and local governments.

Thank you, Mr. Chairman.

Chairman HUMPHREY. Senator Proxmire, do you have a statement?

Senator PROXMIRE. I have no statement.

Chairman HUMPHREY. Senator Taft.

Senator TAFT. Thank you, Mr. Chairman.

Mr. Chairman, I don't intend to make any long statement here this morning, but I think a few facts ought to be pointed out. U.S. News and World Report, on October 6, stated: "New York spends $1,-223.68 per capita while the average for all other cities for the country is $295.48." Even compared only to our larger cities, New York spends far more than its nearest rivals.

Faced with the reality of that, I must say the reaction I'm getting throughout the country to the proposal that the country bail out the city of New York in this situation is not a favorable one. It is overwhelmingly opposed. Political realities, I think, have to be taken into account in this situation.

In part, of course, the New York City problem is because New York State forces its cities to pay one-half of the State's share of a federally supported welfare program. This is especially hard on New York City with its high concentration of poor people. However, even if welfare were completely nationalized, the city would still have been in default, in deficit for many years. For years, the city fathers have ignored an approaching crisis. If bankruptcy means the New York services would collapse, emergency aid would have to be given. But it means no such thing.

The Secretary of the Treasury has testified on this point—and there have been some comments about his testimony, but so far as I know nobody has disproved it—and he says:

"If New York City goes bankrupt, it will continue to operate; tax payments would continue to flow; schools, hospitals, police, fire, and sanitation services would be provided and would be paid for. We evaluated the outlays required to provide the services, and New York City's revenue appears sufficient to provide an adequate level of services.

In short, even if the current State efforts to salvage the city should fail, the only people who would be hurt by suspension of New York debt repayment, directly, would be the bondholders. Thereafter, New Yorkers would be forced to balance the budget, for no one would lend to it again unless it did.

Since the city, I think, must live within its means, to forestall the default with Federal funds, especially with no firm commitment to balance the budget of the city, would be, in my opinion, a great error, a great error to bail out the city at this time.

Chairman HUMPHREY. Congressman Moorhead?

Representative MOORHEAD. I will defer to the chairman of the House Banking and Currency Committee, Congressman Reuss.

Congressman Reuss, we know you have given a great deal of leadership in these areas.

Representative REUSS. Thank you for calling these hearings, Mr. Chairman. Let's go.

Chairman HUMPHREY. Congressman Hamilton.

Congressman HAMILTON. I have no statement. Thank you.

Chairman HUMPHREY. Mr. Burns, we ask you to share with us your views on this problem. You heard the views of some of us.

STATEMENT OF HON. ARTHUR F. BURNS, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

I am here to join you in discussing the economic and financial problems posed by the financial crisis of New York City.

The difficulties now facing New York stem from the erosion of its financial position over the past decade. During this period the expenditures by the city's government grew rapidly while revenues failed to keep pace. To close the gap between its revenues and expenditures, the city relied increasingly on borrowed funds. Not only capital expenditures, but also the mounting deficits on current operations, were financed in this fashion. By the end of 1974, New York City's outstanding debt amounted to over $13 billion, much of which was in the form of short-term notes—that is, obligations maturing in a year or less.

Investors may learn slowly, but their innocence does not last forever. As poor management of New York finances persisted, at first a few but in time more and more investors became concerned about the city's financial condition. During the past winter and spring the city began to experience very serious difficulties in rolling over its debt—to say nothing of adding to its outstanding indebtedness.

Unfortunately, the city failed to take clear-cut remedial measures, and there was some loose talk about an investor conspiracy against the city. The basic facts, of course, were quite simple. First, commercial bankers, being aware of their responsibility for other people's money, felt they may already have approached—if not exceeded—the limits of prudence in their holdings of New York City securities. Second, the many thousands of individuals who invest on their own account likewise focused on safety; they were no longer much tempted by promises of an exceptionally high yield. Investor confidence in the city's finances thus dwindled, while its need to pay current bills and to refinance maturing obligations became more pressing. Once this stage was reached, the possibility of default on the city's obligations became very real, and it was so advertised almost daily in our Nation's newspapers.

The financial crisis confronting the Nation's largest city prompted the government of New York State to offer financial and managerial assistance. Starting in April, the State put at the city's disposal substantial sums that were not scheduled for payment until some months later. Then, around mid-June, the State legislature created a new agency—the Municipal Assistance Corporation (MAC). This agency was empowered to sell up to $3 billion of its debt obligations, which were to be backed by certain tax revenues that otherwise would have gone to the city, and then to make the proceeds of its borrowing available to the city. Armed with such broad authority, MAC sought to wring some clarity out of the city's tangled finances and to help develop a budgetary plan that could lead the city back to a balanced budget.

These measures, however, proved insufficient to restore investor confidence in the city's financial management, and even the new securities issued by MAC soon came under a cloud. To ward off imminent default by the city of New York, the State adopted firmer measures on September 9. First of all, control of the city's finances was turned over to a State-dominated Emergency Financial Control Board. Second, the power of MAC to issue debt securities was enlarged. Third, the State sought to arrange additional financing of $2.3 billion for the city, of which $750 million in loans was to be provided by the State. This financial plan was designed to tide the city over until early December, and it was hoped that by that time the newly organized Control Board would have in being a sufficiently strong program of budgetary restraints to enable the city to resume the sale of its securities to the investing public.

But when investor confidence is once shaken, it can rarely be restored quickly or easily. The new financial plan failed to elicit enthusiasm on the part of investors. In general, the financial community remained skeptical about the city's ability to avert default and rebuild its financial strength. The concern of market participants was heightened by a judicial ruling on September 29 that brought into question a portion of the financial aid package, namely, the purchase of MAC bonds by the State pension funds. Beyond that, the recent intertwining of the State's finances with the city's finances has troubled many investors and damaged the State's credit standing. Thus, the stresses and strains that developed in the municipal securities market over the summer months have become acute in recent days.

Since the summer, and to an increasing degree in recent weeks, the participants in the municipal market—that is, investment bankers, securities dealers, and ultimate investors—have been attempting to reduce their exposure to the risk of loss. This has affected not only securities bearing a New York name, but also issues of some other State and local governments. Thus, many securities dealers have sought to cut back on their inventory of municipal securities, and they have often found it necessary to offer bonds for sale at prices considerably below their purchase price. Underwriters of municipal issues have generally scaled back on their participation in new offerings, thereby protecting their capital in an uncertain and volatile market. Some underwriters have gone so far as to withdraw entirely from bidding syndicates. And investors—the ultimate buyers of municipals—have been tending to shift to higher-quality municipal securities or to categories of investment judged to be less hazardous.

Trading in the market for outstanding tax-exempt bonds has therefore slowed appreciably and the spread between bid and asked quotations has widened. These developments are characteristic of a period when investor confidence has been shaken, and they are indicative of a weakened market.

The recent behavior of investors and dealers has resulted in a rise of the yields on municipal securities to the highest level ever experienced in the tax-exempt market. Yields for even the highest-rated borrowers have risen over the past few months. Some of this increase has been associated with the upward drift of open-market interest rates since mid-year. In addition, municipal yields have been under upward pressure because of the heavy volume of new tax-exempt issues flowing to market. The market for tax-exempt securities is more concentrated, and therefore smaller, than for taxable bonds. Hence, when unusually large amounts of such securities have to be placed, larger yield adjustments relative to taxable markets are likely to occur. Nevertheless, until the last 2 weeks, I would judge that the yields on the highest-rated municipal issues have not been out of line with those available on corporate bonds of comparable quality.

In choosing among tax-exempt securities, however, investors have become increasingly selective. The differences in yields, comparing lower-rated bonds with higher-rated issues, have increased considerably since last spring and have become unusually large. Thus, the average yield on Moody's A-rated bonds now exceeds that on Aaa-rated bonds by more than a full percentage point—or about three times the risk differential required by investors during the preceding 6 years. Thus, the interest cost for lower rated borrowers coming to market has risen materially.

The deterioration of the market for municipals of less than the highest quality has been especially pronounced for obligations of New York City, New York State, and certain of the State agencies. In the case of the State proper, investors have become concerned that the resources being diverted to the city are damaging the financial position of the State itself. Some of the State's agencies that issue "moral obligation" securities rather than "full faith and credit" obligations, have been unable in recent months to finance themselves in the public market. There now appears to be some tendency on the part of investors to underestimate the financial strength of these agencies—an attitude that stems at least in part from the temporary default earlier this year by the Urban Development Corporation. To a lesser extent, there has also been some reluctance by investors to acquire the securities of similar agencies in other States.

During the past week or so, the impact of the market's unease has spilled over to a wider range of securities. Significant increases in yields have occurred in the case of some outstanding bonds of governmental units that enjoy a high financial standing. Moreover, a few issuers have not received any bids for their bonds, or have rejected the bids received because the interest cost was deemed excessive. These developments reflect increasing concern over the crisis of New York City.

If the weakness of the market for municipals were to persist and spread further, many soundly run, creditworthy communities and public agencies could have great difficulty—or suffer excessive costs—in raising needed funds. Holders of municipal securities, among which financial institutions are numerous, would to some degree be affected, and so might others less directly involved. Hence, if the New York City crisis remains unresolved, and if the fate of New York State remains tied to the city's, the process of economic recovery now underway in our Nation could be injured.

Until this most recent turn of events—which I trust will prove to be a transitory phenomenon—the market for municipal securities, taken as a whole, functioned very effectively. During the third quarter of this year, even as pressures associated with the New York City problem intensified, new bond issues amounted to about $9.5 billion. This is by far the largest volume ever for a third quarter, and it would have been a record even in the absence of the $2.4 billion of MAC bonds sold during the period.

In seeking ways to resolve New York City's crisis, the suggestion has occasionally been advanced that the Federal Reserve might serve as a source of emergency credit. No formal application for such credit was ever received by the Board or the Federal Reserve Bank of New York. But I want to explain why we probably would have disapproved such an application had it been made.

As the ultimate source of financial liquidity in the economy, the Federal Reserve has certain powers to extend emergency credit even to institutions that are not members of the System. But the use of that authority is tightly circumscribed. The basic provision—contained in section 13, paragraph 13, of the Federal Reserve Act—states that emergency loans with maturities no longer than 90 days may be made by the Federal Reserve banks on the basis of promissory notes backed by Treasury or Federal agency securities. To qualify for credit assistance under this provision of law, a local government would have to possess sizable amounts of unencumbered Federal obligations. This would be an unusual situation for any distressed borrower, and it obviously does not apply to New York City.

The lending authority under paragraph 3 of section 13 of the Federal Reserve Act is broader, permitting the Board, in unusual and exigent circumstances, to authorize Reserve banks to make loans on the kinds of collateral eligible for discount by member banks. Such paper may not have a maturity of more than 90 days and must afford adequate security to the Reserve Bank against the risk of loss. Furthermore, in view of restrictions of law and congressional intent, certain conditions must be met in order to permit the extension of emergency credit under this authority. Among these conditions is a requirement that an applicant has exhausted other sources of funds before coming to the Federal Reserve, that the borrower is basically creditworthy and possesses adequate collateral, and that the borrower's need is solely for short-term accommodation. It does not appear that New York City is now in a position to meet all these requirements. Certainly, its finances would hardly permit early repayment of emergency borrowings.

In addition to the emergency lending provisions in section 13 of the Federal Reserve Act, the Reserve banks have authority under section 14(b) to purchase short-term obligations of State and local governments issued in anticipation of assured revenues, subject to regulations by the Board. Legislative history indicates that this authority was designed to assist the Federal Reserve banks in meeting their operating expenditures, and also to enable them to make the discount rate effective when little borrowing took place at the discount window. There is nothing in the Federal Reserve Act or its legislative history to suggest that section 14(b) contemplated the purchase of municipal securities as a means of aiding finaicially distressed communities.

The Congress, of course, could amend the Federal Reserve Act so as to relax the requirements for extending Federal Reserve credit to financially troubled governmental units. But the Board of Governors would have the gravest doubts about any such action. If loans were to be made to State or local governments, the Federal Reserve would have to involved itself in the activities of these governmental units, including particularly their expenditure budgets and the adequacy of their revenues. Moreover, since numerous demands for credit might ensue, the Federal Reserve would have to set standards of eligibility. Being thus placed in the position of having to allocate credit among governmental units, the Nation's central bank would inevitably become subject to intense political pressures, and its ability to function constructively in the monetary area would be undermined.

The Board fully recognizes that the Federal Reserve System has the responsibility, subject only to restrictions under existing laws, to serve as the Nation's lender of last resort. Over the years, we have therefore developed contingency plans to deal with possible emergency situations. As I previously informed the chairman of this committee, our plans have been adapted recently to cope with the financial strains that might be associated with the default of a major municipality.

In that event, I assure you, the Board is prepared to act promptly. The contingency plan calls for lending to commercial banks through the Federal Reserve discount window beyond the amounts required by normal discounting operations. Credit provided in this manner would assist banks in meeting their temporary liquidity needs. Not only that, the proceeds of the special loans made at the discount window could also be used by the banks to assist municipalities, municipal securities dealers, and other customers who are temporarily short of cash because of unsettled conditions in the securities markets. In addition, the System would, of course, be ready to use its broad power to stabilize markets through open market purchases of Treasury or Agency securities.

In the event this contingency plan has to be activated, the Board will make funds available on whatever scale is deemed necessary to assure an orderly financial environment. The Board recognizes that sizable extensions of Federal Reserve credit would run the risk of leading to a substantially larger expansion of bank reserves and the money supply than is consistent with longer-run monetary objectives. Clearly, therefore, any such expansion must be only temporary. In time, any excessive growth in bank reserves would need to be corrected through offsetting open market operations and through repayment of bank borrowing from the System.

There are also certain supervisory and examination questions that may arise with respect to banks in the event of a major municipal default. In this connection, the Board and other regulatory agencies have plans to revise procedures that apply to the valuation of defaulted securities, so that any writedowns may be postponed until the market has had a few months to stabilize and thus provide more reliable indications of their value.

Even so, a default may ultimately require writedowns that could seriously impair the capital of some banks. In that event, the Federal Deposit Insurance Corporation has statutory powers to assist federally insured banks that might find their capital impaired by a decline in the value of securities in their portfolio. I understand that the Corporation is prepared to implement, with appropriate safeguards, its contingency plans for dealing with insured banks that require a temporary infusion of supplemental capital for the above reason.

I think it evident from the far-flung scope of our contingency plans that we believe a default on debt obligations by New York City could produce serious strains in securities markets. For a time, it could also adversely affect municipalities that need to issue new debt. The like is true of financial institutions that hold such securities in significant volume, and also of individual investors who have part of their life savings at risk in these bonds. I still believe that the damage stemming from a prospective default by New York City is likely to be shortlived. Indeed, the possibility of such a default has already been discounted to an appreciable degree by the market. But I am also aware of the uncertainty that inherently attaches to a judgment on this score; and I recognize that a default, besides being a very serious matter for the city and State of New York, could have troublesome consequences for the Nation at large.

The very fact that this committee and other committees of the Congress are holding hearings on New York City's finances implies that concern is spreading that a New York default may injure the economic recovery now in process. I have said enough to indicate that I feel this possibility can no longer be dismissed lightly. That, however, does not ease the task that the Congress faces in dealing with the New York problem; for the precise issue is whether Federal financial assistance to New York may not cause national problems over the long run that outweigh any temporary national advantage.

As this matter is debated by the Congress, the adverse effects of a New York City default will undoubtedly receive full attention—as they indeed should. I would only urge that the longer-run risks also be considered thoroughly. A program of Federal assistance to the city may well lead to demands for similar assistance for the other hard-pressed communities, even those whose distress was brought on by gross negligence or mismanagement. Substantial Federal credit—whether through insurance, guarantees, or direct loans—would compete directly with the already huge amounts of Federal financing needs. Most important of all, the provision of Federal credit for local government will necessarily inject a major Federal presence in local spending and taxing decisions.

It is highly important, therefore, to recognize that the issue of assistance to New York City goes to the very heart of our entire Federal system of separation of powers—a system that, despite enormous economic and social changes, still prevails in our country.

Thank you very much, Mr. Chairman.

Chairman HUMPHREY. Mr. Burns, we express our thanks to you for a very thoughtful and well documented statement this morning on a subject that has immense possibilities for good or evil. I don't suppose this committee has dealt with any subject that has any more immediate possibilities for market repercussions than this one. Therefore, I hope, at least on my part, that my questioning will be carefully thought out and in no way indicate any precipitous or unwise action or statement of policy.

I believe you have given us sufficient warning as to the significance of what we are contemplating and also the necessity of some form of action. I would like to refer to your testimony where after having discussed with us some of the authorities and powers that the Federal Reserve has as a source of emergency credit and also the limitations that are placed upon those powers, you state in the final paragraph:

> In addition to the emergency lending provisions in section 13 of the Federal Reserve Act, the Reserve Banks have authority under section 14(b) to purchase short-term obligations of State and local government issues in anticipation of assured revenues, subject to regulation by the Board.

And then you say:

> Legislative history indicates that this authority was designed to assist the Federal Reserve Banks in meeting their operating expenditures, and also to enable them to make the discount rate effective when little borrowing took place at the discount window.

And then you go on to note other things that we could do and state that the Board recognizes that the Federal Reserve System has a special responsibility to serve as the Nation's lender of last resort.

You also assure us that the Board is prepared to act promptly. And then you indicate what you said you would do in your role as Chairman of the Board of Governors of the Federal Reserve System as to the action the Federal Reserve Bank would take in case an emergency treatment was demanded.

Now on the basis of that background, Mr. Burns, the one mechanism that the Federal Reserve System has available at this moment, and in fact the only mechanism in the entire Government that would not require additional legislative authority, is the authority to purchase bills, notes, and revenue bonds of State and local governments with maturities of up to 6 months.

I gather that is the authority you have, is that correct?

Mr. BURNS. I believe that is correct.

Chairman HUMPHREY. Therefore, if it became apparent that the MAC financial plan was going to fall apart before December—and I believe you have indicated there are some judicial proceedings already and decisions handed down—if it became apparent that this was going to happen before Congress had a chance to act, but the Congress was moving toward a legislative solution, then my question is—after all of this preface—would you use this authority, this limited authority under section 14(b) to provide a bridge until the congressional mechanism were put in place?

Do you get the picture I'm trying to draw here, Mr. Burns, that it takes time—even if we have the best of intentions and want to proceed with the caution and prudence that is necessary—it is going to take time for Congress to act. Yet in the meantime, there may be a very serious financial situation that develops. You have indicated that the tempo of that emergency seems to be increasing. And in the last couple of weeks, things have been much worse.

So my question, therefore, is would you use the authority to provide a bridge until the congressional mechanism was put in place?

Mr. BURNS. I don't think that I am in any position to really answer that hypothetical question, Mr. Chairman. I can only say this: That our attorneys would probably advise strongly against it on the grounds that neither the Federal Reserve Act nor the legislative history of the Act would warrant any such use of our powers.

Chairman HUMPHREY. All right, Mr. Burns, I recognize the concern that you have in your very important role as the Chairman of the Board. If the Congress were to pass a concurrent resolution instructing the Federal Reserve to exercise this authority, this emergency authority which you have, which you outlined here, starting in that paragraph, would you comply with the provisions of the resolution?

Mr. BURNS. That resolution would not have the force of law, as you know Mr. Chairman, and I am unable to give you a definitive answer at the present time. But in all honesty, I can really not encourage the thought.

Chairman HUMPHREY. Let me just take you one step further. I am not doing this to be contentious, but frankly to get guidance. If Congress were to pass a joint resolution, not a concurrent resolution but a joint resolution, which requires a Presidential signature, if Congress were to do that, instructing the Federal Reserve to use this authority, would you recommend that the President sign the resolution?

Mr. BURNS. I would have to wait until that time occurs before I could answer that.

Chairman HUMPHREY. Well now, Mr. Burns, let's assume that you gave advice to the President—and I'm not saying what kind of advice that you gave him—but let's just assume that the President did sign it, then would the Board comply with the instructions of the resolutions?

Mr. BURNS. If Congress passed a joint resolution to that effect, requiring the Federal Reserve to do almost anything that is humanly possible and if the President signed it, I assure you we would obey that law promptly and live in accordance with the letter and the spirit of that resolution. We are a very law-abiding group. [Laughter.]

Chairman HUMPHREY. That is a very reassuring statement these days. [Laughter.]

Mr. Burns, I hope you understand that I am not arriving at any prejudgment because, as I have indicated, this whole matter is a very difficult one. You have surely spelled that out. There will be testimony to the contrary. There are those of us who feel the Government, that the Federal Government, must take some sort of action. I'm just here probing the kind of action that we ought to take.

Now as an economic adviser to the Congress, which is part of your role, would you advise the House and the Senate to enact some form of legislation that would assist New York City and New York State prior to default rather than waiting for the bankruptcy procedure?

Mr. BURNS. That is a very difficult question for me, Senator. I have been struggling with that question for weeks. I haven't yet reached the point where I can, in good conscience, advise the Congress to pass legislation to assist New York City. However, I can say this: That if you were bent to do so—and you, at least Senator, seem to be in that mood—I would give you some counsel as to how you might proceed. If you were to write legislation, I think that the legislation should provide for some very stringent measures designed to keep down severely the number of municipalities around the country that might need to be bailed out.

For example, if a bill were drafted, I think it should require as one condition, that the municipality cannot raise funds in any other way except through Federal assistance—through, let us say, a Federal guarantee of its debt issuance. I think a second condition that would make good sense would be to require that the State take over the management of the municipality that finds itself in financial difficulty—that is, take over the management of the municipality's finances. I think that a third condition might well be that the State discharge its responsibility to its own municipality by levying a special tax that would cover, let us say, one-half of the deficit that is faced by the municipality.

Another condition would have to be that the Federal authority, whether it be the Treasury or the Emergency Loan Guarantee Board or some other entity, should approve a financial plan that is developed by the State-dominated control group and that is designed to restore the city's finances in a relatively short period.

And of course, there would have to be a guarantee fee if you travel this route, and the period to which the guarantee would apply would have to be severely limited.

Now, I'm not recommending that legislation. I'm not recommending any legislation. I'm conveying a thought, mainly, that the conditions ought to be so stringent, ought to be so severe, that very few municipalities would want to exercise or take advantage of this power.

Chairman HUMPHREY. Mr. Burns, let me assure you that those of us who have even contemplated Federal assistance or Federal action in this area have kept in mind many of the restraints that you have indicated.

It is a fact, of course, that local governments are the creatures of the State, and therefore a State government has a special responsibility. In the instance of the State of New York exercising some of that responsibility, one of the matters of grave concern, which you have indicated in your testimony, is now the State of New York, and not only the city of New York, is beginning to find itself in some potential or possible difficulty. I don't know the degree, but there are some indications of that. So that you get this kind of ripple effect, which isn't so much rippling as it is kind of ripping, in which the bond market, the securities markets, not only for municipalities but for the State government, become jeopardized.

And the question that I have in mind, and I know my time has expired, but I want you to contemplate it as you visit with others today, Mr. Burns, is when and at what point and under what circumstances do the instrumentalities of the Federal Government come into play, if at all? I happen to think that there must be a time that they do come into play. If the damage that would be done to the financial structure of our country, to the economy, is of such proportions that it would seriously affect the economic recovery and the stability of our system, of our financial system.

So we will come back again. I just want you to know my concerns. I know that helping New York is not a popular political issue. I was asked about that this morning by some reporters. I suppose the popular political way is to turn your back on New York. But may I say that I believe that this is a time, no matter what way we seek to help—and I'm not so sure which is the best way—but I think this is the time where the phrase "bite the bullet" really has to be a fact. I think there has to be some way to assure that a major economic catastrophe does not take place.

And when a man of the quality of the Chancellor of the Federal Republic, and one of the top financial officials in Switzerland, reminds us of the international repercussion, and when you, sir, today, in a very thoughtful statement—and I want to thank you for it—remind us of the possibilities, not necessarily the certainties, but the possibilities of serious financial problems here at home, then I think that we have to dig in. And I think we have to have our emergency plan at the congressional level, just as you have prepared an emergency plan at the Federal Reserve level.

I yield to Senator Javits.

Senator JAVITS. Thank you, Mr. Chairman, and thank you, Mr. Burns.

I thoroughly agree with the chairman as to the sagacity with which you always testify, and it is not different today.

I have a rather deep philosophical question that troubles me. When even so distinguished and objective an authority as the Chairman of the Federal Reserve Board uses in his answers the words "bail out," of New York being "bailed out," and when my distinguished colleague, Senator Taft—and I am sorry he is gone—uses a similar expression, perhaps a little more severely, then I want to raise this philosophical question.

I noticed in your statement, Mr. Chairman, you said: "Even those whose distress was brought on by gross negligence or mismanagement," and you say: "A program of Federal assistance to the city may well lead to demands for similar assistance for other hard-pressed communities, even those whose distress was brought on by gross negligence or mismanagement."

My question is this. Mr. Chairman, is this situation very much different from the farmer in Mississippi who lost 1 million or 2 million chickens because he didn't take the proper precautions with his flock, and yet the United States, by special legislation, bailed him out? Do you see any difference in this situation where vast numbers of people and vast human interests are involved?

Mr. BURNS. I think there is a difference, Senator. We have developed a certain structure of Government in our country, and we have proceeded on a doctrine of separation of powers. The Federal Government has not involved itself previously in the management of local community affairs. Assistance has been provided to cities under general legislation, but the Federal Government, to the best of my knowledge, has never told a city how much it should spend or how much it should tax or in what way it should tax. So I think there is a difference in the two situations, though from a human viewpoint, there is basic similarity. That is, of course, what I think you are talking about.

Senator JAVITS. Isn't it a fact that many of the points you just made are eroded when you look at the Lockheed loan? Lockheed is a corporation, and how often has the United States told corporations what they should spend and what they should save, et cetera?

Mr. BURNS. You have asked me the most difficult question that you possibly could. I have struggled with that question, and I am even embarrassed personally because I was in favor of the Lockheed loan at that time. I have thought for some time, long before the New York City difficulties broke into the open, that I was mistaken and that the Congress was mistaken and that the Lockheed—well, let me just use that awful term "bailout"—that the Lockheed bailout was a mistake.

And when you ask me the question, "Well, if you did the one, why not the other?" I would have to throw up my hands because I cannot give a good answer. I have tried to develop a good answer. I can't find one. But all I can say is that we made a mistake in that case. Let us not multiply our mistakes.

Senator JAVITS. Now, of course, the Lockheed thing hasn't worked out all that badly, has it?

Mr. BURNS. Perhaps I have a certain conflict of interest here. I am a member of the Emergency Loan Guarantee Board, and in my view the Lockheed problem has taken a great deal of my time and has been a drain on my energy, and I am not satisfied with the way Lockheed has handled its affairs. And I wish, if you are ever going to do things in this area, I wish and I hope that you will have just an ounce of sympathy for the Chairman of the Federal Reserve Board who has to deal with matters like Lockheed.

Senator JAVITS. Mr. Chairman, I don't bridle at your difficult requirements for assistance for New York, which are really spartan in character. That is why I violently objected to the word "bailout." It is a bailout when someone pays for someone else's mistakes——

Mr. BURNS. Let me take——

Senator JAVITS. Let me just finish the question.

Mr. BURNS. Well, let me take that word back. It is a careless term, and the meaning is not too clear. I didn't really mean it in any invidious sense. So let me take back the use of this term "bailout" because it will not help us communicate with each other.

Senator JAVITS. But it is a sharp cutting edge, Mr. Burns, and you know my great affection and respect for you. But I'm really trying to equate this with the people. The word is very loosely used. My colleague, Senator Taft, is not a man of ill-will, and he has a city in his own State which is almost right behind New York—to wit, Cleveland—which has its own troubles. But be that as it may, the fact is that the word is very widely used. So I think it is very important to see whether the kind of spartan regime that will now be imposed inevitably on New York City by either the State or the Federal Government or both or of its own necessity—and obviously that is going to happen. Now, is that a bailout? We are not paying for New York's mistakes. New York will suffer from its mistakes. But we are trying to save it from a calamity which could involve the whole country. Let's us remember the Great Depression of 1932. That depression was touched off not by the failure of a city—to wit, the principal megalopolis in the world—but by one bank in Austria. So let us not be so high and mighty about risk taking. You yourself, Mr. Chairman, have testified—and I am a fairly careful lawyer—and in your opening statement, you said:

Nevertheless, until the last 2 weeks, I would judge that the yields on the highest-rated municipal issues have not been out of line with those available on corporate bonds of comparable quality.

Now, Mr. Chairman, what has happened in the last 2 weeks which is a forecast of the future? What is the handwriting on the wall? What are the flickering shadows as the sun of New York City sinks over the horizon?

That was a little elegant. [Laughter.]

Mr. BURNS. Financial markets, as I think you know, Senator, do not thrive on uncertainty. This is a major factor in market behavior now. A resolution of the New York City crisis, either one way or the other, I believe—and I may be mistaken—would be most important.

Senator JAVITS. Mr. Burns—let me say in the first place, I appreciate the precision with which you have testified. Here you have men of very diverse views but with the greatest good will toward this crisis; namely, Senator Humphrey and Senator Proxmire and the other members of this committee and the Congress. So your guidance is important, and to me, not a bit unexpected. That is why, as I said, I do bridle at the words "bail out" because I knew the terms would be extraordinarily tough. They have to be. I would feel that way myself, and I represent the State which is involved in this, not just the city of New York.

So I would like to ask you this question. You said: "A program of Federal assistance"—in your oral statement—"to the city may well lead to demands for similar assistance for other hard-pressed communities." Now, isn't it just as likely, no more or no less, that default by New York would so sour investors on the municipal obligations that those communities would be unable to rollover their obligations and thus you may touch off a whole series of defaults by many cities which may just be hanging on by their teeth?

Mr. BURNS. I think I have indicated in my testimony that I am aware of that possibility, and I am aware also of the fallibility of my own judgments. I have been watching this very, very closely, and I am at a different point today than I was a month ago.

Senator, I believe that while this possibility exists and while even the probability is not necessarily low, I doubt if that will happen for very long. But I may change my mind as I see how markets behave.

Now, if I may, Senator, I would like to give this word of counsel. I don't know whether my counsel is practical or not, but if you are going to do something about New York—and I am not advising you to—but if you are, I wish you would do it quickly.

Senator JAVITS. I agree with that thoroughly. Thank you.

Chairman HUMPHREY. Senator Proxmire.

Senator PROXMIRE. Mr. Burns, I agree this is a remarkable statement; remarkably thoughtful, balanced, and it is also a great "on the one hand, but then on the other hand" statement. In other words, it is hard to tell where you come down until the questioning. And in the questioning, I seem to perceive, in your responses to Senator Javits' question with respect to Lockheed, the Lockheed loan, that you would oppose a guarantee under any circumstances we can conceive of, a guarantee to New York to the present time.

You just said you might change your mind, but that is your present view. Is that right or wrong?

Mr. BURNS. That is the way my thinking is running at the present time, but, as I indicated, it is my business to respect facts, and facts have a way of unfolding. The world doesn't stand still. What I have tried to indicate is that if the Congress is in a mood to deal with the New York City problem or the broader municipal problem as you may see it, then I hope that you will write into the law very stringent conditions; that you will write into that law conditions that would definitely involve the State so that the State will discharge its financial responsibilities; and also that the law be written in such a fashion that the communities that would seek relief under such legislation would be very few indeed.

Senator PROXMIRE. Well, I agree wholeheartedly with that. I think you have performed a great service in emphasizing that and underlining it. I think Senator Javits has agreed with that. I think, as a matter of fact, there is no way any legislation could be enacted into law without following your advice and following your advice just as stringently as you have emphasized it.

Let me see if I can clear up something else that is a little unclear in my mind. Did you indicate that if the Congress passed a concurrent resolution, which would not have the force of law but which would implement a law which is in effect, telling the Federal Reserve to buy New York City obligations, that you would have some hesitation as to whether you would follow what Congress has told you to do, although you are a creature of the Congress? You're independent of the Executive but a creature of Congress.

Mr. BURNS. Well, I indicated or tried to indicate——

Senator PROXMIRE. I don't mean you are a creature of Congress. I meant the Federal Reserve Board is.

Mr. BURNS. Well, I think I am too. I wouldn't be here if you hadn't confirmed me.

Senator PROXMIRE. All right.

Mr. BURNS. You can change your mind any day. [Laughter.]

Now, I indicated, or I tried to indicate first of all, that I think it would be unwise for me—perhaps even improper—to answer hypothetical questions. I tried to indicate second, that a concurrent resolution does not have the force of law.

Senator PROXMIRE. Well, let me interrupt to say you were completely unequivocal in saying you would follow the law if we passed a joint resolution that was signed by the President.

Mr. BURNS. No question about that.

Senator PROXMIRE. Well, why can't you be unequivocal in saying that you will follow what Congress decides to do since we are the masters of the Federal Reserve Board?

Mr. BURNS. A concurrent resolution, as you know, does not have the force of law, and we have a Government under law. I'm not an attorney myself. On a matter of this kind, I would need the counsel of the Board's attorneys. I gave you the best answer I could under the circumstances.

Senator PROXMIRE. All right, sir, now let me see if we can get to what has been done in the city of New York already and the extent to which this might be strengthened in legislation. As I understand it, the city of New York has already reduced expenditures by over $1 billion. They have increased taxes; they have surrendered substantial powers on spending, taxing, and issuing securities to the State; and they are committed to balancing the budget within 3 years. The State has assumed substantial responsibilities for the city's obligations, as you say in your statement, and created instruments to make sure that this is carried out. The State has increased the city's taxing authority and has in effect, enabled the State to increase taxes, which they have done. The State has loaned a substantial amount of money, perhaps more than they should have prudently done so, a substantial amount to the city. They have gone about as far as could be expected.

Under these circumstances, if we should design legislation that would provide for a Federal guarantee with a taxable instrument, which would be a penalty which would have to be paid; legislation which would require on top of that as a kind of insurance premium; a requirement that the city meet such additional Federal demands with respect to spending and taxing as the people administering this program in the Treasury or Federal Reserve Board might require; and requiring also that the State serves as an enforcement agency; and provided also that the guarantee be partial—that is, be not a 100-percent guarantee but a partial guarantee—that perhaps would range all the way from 25 percent for a guarantee to 75 percent for the guarantee—then does it seem to you that within that kind of limitation, Mr. Burns, that kind of demand on the city and the State, that you might have a reasonably strict instrument or did you have something else in mind?

Mr. BURNS. If I understood you fully, you have made no reference to a specific sacrifice that the State itself might make in the way of an increase in its own taxes, with the increase to be for a limited period of time. The increase would indicate the State's recognition of its responsibility. It would be a special tax to redeem the honor of the State. I consider this to be a very important feature of any such legislation you may decide to pass.

Senator PROXMIRE. As I recall, you said that that tax should be at least 50 percent of the deficit?

Mr. BURNS. That seems reasonable, 50 percent.

Senator PROXMIRE. All right. I think that is a very reasonable suggestion that should be put into effect. But even if we should do all of that, however, you would not commit yourself at the present time to this guarantee and in fact, at present moment, you would be disposed to oppose it. Is that correct?

Mr. BURNS. As of today, I still have grave doubts about the wisdom of that legislation.

Senator PROXMIRE. Now, how would you distinguish emergency credit assistance for New York from the aid to the Franklin National Bank? In that case, the Fed provided a direct loan to the bank, not a guarantee, to the amount of $1 billion to $1.7 billion or six times the amount of the Lockheed loan guarantee. The bank was obviously very badly managed and made enormous mistakes of judgment. How would you justify the Franklin assistance compared to the New York request?

Mr. BURNS. I think that is very easy to justify, Senator. The Franklin National Bank was a member of the Federal Reserve System. By being a member, it had been taxed very heavily over the years. Under the law, we have a responsibility to come to the assistance of member banks through the discount window. And in the case of Franklin, Senator, we had collateral with a value that exceeded the amount of the loan that we gave. This was a bankable loan. We were fully protected.

Senator PROXMIRE. All right. Well then, this is the reason I presume, or one of the reasons why you emphasized strongly the desirability of a tax by the State of New York, for instance, that would pay a substantial part of the deficit as similar to the kind of payments that the Franklin National Bank made?

But it is a different kind of situation. I think most of us would have more sympathy for a city in these circumstances than for a private enterprise bank that, after all, takes its risks like any other business.

Mr. BURNS. I had no sympathy for that bank, Senator. I think you know that. You described it as a poorly managed bank, and of course it was. And everyone knew it. I couldn't care less about that bank. But I did care about the banking system and about the financial system and the domino effect that the failure of a $5 billion bank could have upon our entire banking system and for that matter on international finances.

Senator PROXMIRE. Why isn't there a domino effect in the bond market?

Mr. BURNS. There could be. I talked about that in my testimony.

Senator PROXMIRE. One other question. If the Congress sets up a board similar to the Loan Guarantee Board to administer assistance to municipalities, do you think the Chairman of the Federal Reserve Board should serve on that Board?

Mr. BURNS. This is a question that I have struggled with. I advised the Lockheed legislation, and under that legislation, a board was set up with the Secretary of the Treasury as chairman and the Chairmen of the Securities and Exchange Commission and the Federal Reserve Board as associate members. Now that was the best kind of a board that I could think of at the time. In this situation I have been trying to think of a board that would exclude the Federal Reserve Board, and that would act responsibly—that would bring good financial ability to the job at hand. I hope you can find one. So far I have not been very successful in coming up with a good suggestion to you.

I would much prefer to see the Federal Reserve Board omitted. On the other hand, it may be difficult to find a good replacement.

Senator PROXMIRE. Thank you, Mr. Chairman. My time is up.

Chairman HUMPHREY. Congressman Moorhead.

Representative MOORHEAD. Thank you, Mr. Chairman.

Mr. Burns, 2 weeks ago the Secretary of the Treasury testified before this committee that: "New York City, with the assistance of the State, has both the mechanisms and the resources to avoid default." Now in your testimony, I noticed, you talk about: "During the past week or so," and at another point, you said "until the last 2 weeks," and at another point, you said, "until the most recent turn of events." Is it you opinion today that New York City, with the assistance of the State has the mechanisms and the resources to avoid default?

Mr. BURNS. That is a very difficult question. I do think that New York is a rich and powerful city and that if a creditable financial plan were developed, it might still stave off default and restore confidence. But a financial plan that could have worked 6 months ago could no longer work 3 months later; and a financial plan developed 3 months ago or even 1 month ago, may no longer work today. Therefore, I'm not at all sure that this can be done. However, I have not seen a sufficient effort made.

Representative MOORHEAD. What kind of efforts would you like to see, Doctor?

Mr. BURNS. Well, first of all, New York City finances have had their ups and downs. One day employees are discharged, and the next day or the next week, they are rehired. This has created great confusion among investors and has served to erode confidence that might otherwise have been built up. As far as the State is concerned, I think it would be fair to say that the State has imperiled its own credit in the process of coming to the assistance of New York City.

Essentially what has happened is that debt has been moved out of one pocket into another pocket and the total amount enlarged in the process. The State has not imposed a direct sacrifice on itself—for example, in the form of a special tax for a period of 1 year—in order to come to the assistance of this great city. Thus the State has failed to build confidence in the finances of that city, or the finances of the State.

This is my estimate of the situation. You might say that it is a personal estimate and, of course, it is that. But I think that I am correct in saying that what has happened so far has not helped to restore investor confidence. On the contrary, it has continued to weaken the confidence of investors.

Representative MOORHEAD. But Mr. Burns, I would like to get some idea of your notion of the magnitude of New York City's problems.

Mayor Beam, if I recall correctly, testified before this committee that his problem was a short-term cash-flow between now and the end of next June, with the amount of approximately $1 billion. Most of the other people who have looked at it, they give me considerably higher figures. Do you have an idea of the magnitude of the problem?

Mr. BURNS. I think I do. It is much more than a cash-flow problem because, if I understand the finances of New York City correctly, New York City's debt is scheduled to go up by something like $1 billion this fiscal year. Now that is not a cash-flow problem.

That is how I read the estimates that I have seen. Of course, a new plan is to be submitted in a day or two and that plan may modify the picture. But we are not dealing here solely with a cash-flow problem.

Representative MOORHEAD. And it is considerably larger than $1 billion?

Mr. BURNS. Oh, yes.

Representative MOORHEAD. Now, Mr. Burns, suppose these plans do not work out, and New York City has to default. And I think the date usually given is in December. What happens then? On what do they default and what is the ripple effect?

Mr. BURNS. I wish I could answer that, Mr. Moorhead. It is a very difficult question of judgment. The effect cannot be salutary; it cannot be good. The only queston is how serious it is likely to be for New York and for the rest of the country.

And it looks more serious to me today than it did a few weeks ago. A few weeks ago, it looked more serious than a month ago. But I still do not consider it a catastrophe. A default on the part of New York City would be most regrettable, but what would trouble me much more is if a default by New York City were accompanied by a default by New York State. In this connection it is worth noting that the various special agencies that New York State has created have issued a rather large volume of moral obligation bonds that presently are outstanding.

Representative MOORHEAD. Could that be serious enough to trigger a really serious recession?

Mr. BURNS. When you ask "could it be?" I think the answer has to be in the affirmative. But if you were to ask me whether I think that would happen, I would answer today in the negative. I do not think that would happen, but I recognize my judgment could be erroneous.

Representative MOORHEAD. I appreciated your statement today that if the Congress is going to do something, we should do it quickly. Now was that advice given because of the fact you think this would help to restore investor confidence and would require less action or less money involved now than it would be if we postponed it 2, 3, or 4 months from now?

Mr. BURNS. As I said before, the market can take a change in values and adjust to it. But the market functions badly when the people have no idea of what is going to happen and when uncertainty is very great. That is the thrust of my response.

Representative MOORHEAD. So in your advice, you are considering the possibility that if this legislation or some other kind of legislation with the strict requirements you suggested were put into place, it might have a beneficial effect on confidence in the market? Is that it?

Mr. BURNS. Yes, it might have a beneficial effect on the market.

Representative MOORHEAD. The reason for your opposition is that if you knew that it would stop there, fine, but you are concerned that this precedent would then be used by other cities with financing implications that the Federal Government would consider adverse? Is that the reason you would be opposed to this legislation?

Mr. BURNS. That is correct. I do think that self-reliance in our country, which has been diminishing, would be dealt another blow.

Representative MOORHEAD. Thank you, Mr. Burns. Thank you, Mr. Chairman.

Chairman HUMPHREY. Congressman Reuss, you have legislation before your committee and you have your own proposal. We will turn to you now.

Representative REUSS. Thank you very much, Mr. Chairman. I want to thank you, Mr. Burns, for giving this very impressive and instructive testimony. I want to summarize what I gather is your view: First, you believe that the Federal Reserve should not directly mount a rescue mission for New York City. And I think you are right in that. I don't really think you are going to be faced with the terrible choice of whether to have a concurrent resolution to that effect or not. Second, while you are not quite prepared this morning to urge Congress to act, but you did mention two things: One, if Congress does act, you believe that there should be certain ironclad conditions on how it acts—and I find myself in very general agreement with your listing of conditions including particularly your mention of the fact that Federal exposure of the United States should be short in duration and limited in time; two, if Congress is to act, then it should be done quickly. Thirdly, when you get to what the Federal Reserve can do, I again find your answer very satisfactory if I heard you right. You were saying that the Federal Reserve stands committed, as lender of last resort, to see that no holders of New York securities in the banking system, whether they be National or State banks, whether they be Federal Reserve members or nonmembers, whether they be insured or not insured, you are saying no bank holding New York securities will be allowed to suffer a measurable liquidity squeeze.

Mr. BURNS. I would put our position this way, Mr. Reuss. We would come to the assistance of any bank having a temporary liquidity problem at the discount window whether that bank is a member of the Federal Reserve System or not and whether or not it holds New York City securities. If the existence of a liquidity problem becomes fairly general for a time under conditions of uncertainty, we would deal with it on whatever scale is necessary. Our monetary growth targets would just go out the window. We would attend to our monetary targets later on. We wouldn't forget about them, I assure you.

Now, I want to make this additional explanation. We would lend our assistance at the discount window not only to member banks, but also to nonmember banks, but the nonmember banks would be subject to a higher discount rate.

Representative REUSS. I think that is a good way to do it.

Let me recapitulate what I said you said. By your discount window operation, the following should be clear, should it not, that if the paper discount ultimately loses value, that is not the responsibility of the Fed. The Fed then looks to the bank that brought it in and is made whole. So there is no exposure of the taxpayers' money involved in this.

Mr. BURNS. Oh, no, we would be lending to the bank.

Representative REUSS. And that is an important distinction and one that has to be made.

Mr. BURNS. The risk we take is making the loan to the bank, but that is what we are here for.

Representative REUSS. And you then point out two subsidiary things that can be done for the banking system: One is the attitude of the regulatory agencies such as the Fed, the FDIC, and the Comptroller of the Currency, and that attitude would to go a little easy on bank writedowns of the questionable paper, if that is the way it turns out to be. And I think that makes sense. And then finally you said that the FDIC—and this is part of your oral statement—is prepared to implement with appropriate safeguards its contingency plans for dealing with insured banks that require a temporary infusion of supplementary capital.

Now, I don't know quite what that is, but doesn't that sort of duplicate what you are doing at the discount window? How does that differ?

Mr. BURNS. Well, we do not supply capital, supplementary capital.

Representative REUSS. It comes to the same thing though, doesn't it?

Mr. BURNS. No; not quite. You see we are and must be governed by law, and we cannot lend to an insolvent bank. If a bank finds its capital has eroded, the FDIC in its own fashion, which I will not attempt to describe only because I don't know what it is precisely, can supply supplementary capital and keep the bank solvent so that we are then in a position to lend. If the bank were insolvent, we could not lend a nickel.

Representative REUSS. Now let me turn to the broader economic facade. You have said many times that the next 12 months are going to be very important months for our country's economy, and you have also recently said many times that in your judgment further stimulus is not required at the present time. Weren't you somewhat surprised when the President, who has seemed to agree with you on that, on television, Monday night, announced the largest tax reduction in history. It was something like $28 billion. And any setoff against that is to occur after the elections by some similar decline in expenditures. We needn't concern ourselves with that because we are concerned with the next 12 months.

But would you not agree with me that it would be irresponsible of Congress to enact such a program?

Mr. BURNS. The way I would do it would be to have a tax reduction and a cutback of expenditure of an equivalent amount to take place concurrently.

Representative REUSS. So, would you agree that to throw the budget into imbalance by billions of dollars for the next year, with no expenditure decline until after the election would be irresponsible?

Mr. BURNS. I neither agree nor disagree. I have given you my view. If I were doing it, I would do it on an equivalent and concurrent basis.

Representative REUSS. Well, I wish you were even more independent. Thank you very much.

Chairman HUMPHREY. You came a long way.

Mr. BURNS. I state my views with some precision or I try to. You asked me before whether I was surprised, and I'm not. I have lived in this city for some time. This city no longer surprises me.

Representative REUSS. Well, thank you very much. My time is up, Mr. Chairman.

Chairman HUMPHREY. Congressman Hamilton, did I understand you would yield to Senator Percy?

Representative HAMILTON. I yield to Senator Percy.

Senator PERCY. I want to express my appreciation to Congressman Hamilton. He is a very good friend in giving me this courtesy this morning. You are not only well represented here today, but I would say on this side these empty chairs here do not indicate a lack of interest on the Republican side of the aisle to the problems of New York and the complexity of this problem.

I agree with the chairman. This is the most complex situation that I have tried to arrive at a just and fair decision on. I think your testimony this morning, Mr. Burns, is extraordinarily helpful. I think we are all concerned about the ripple effect and about what is going to happen if we don't do certain things. That is what we are trying to struggle to find out. But I find that all kinds of new factors, Dr. Burns, are coming into the picture to be taken into account in any assessment.

I would like very much to have the benefit of your comments on certain things that have occurred since you were last here with us. The President has announced a $100 billion program for energy, which may be called a backdoor financing effort by the Federal Government. The President has called for a $28 billion tax cut and that puts a further strain obviously on the budget, on our ability to cut expenditures, and pressures on us to do so, but also is a hopeful stimulant to the economy. Then we have evidence indicating that the recovery is moving slower in the economy than we had thought and that the money supply is running at the lower end of the target range. Could you comment on all three of those factors as to their effect upon the ability of the Federal Government to just jump right up and say we will bail New York out?

Mr. BURNS. I can comment with greatest confidence on the behavior of the money supply. If you take the narrowly defined money supply, it has increased at an annual rate of 7 percent during the past 6 months—between March and September. For a broader definition of money—one that also includes deposits in savings banks, time deposits in commercial banks, and deposits in the savings and loan associations and the credit unions—the rate of growth has been 13 percent. So this country is not being starved for money.

Now you commented on the recovery proceeding at a slower rate than expected. I think the recoverwy has been proceeding satisfactorily, Senator. We had a sharp increase in the volume of production during the third quarter. We had a significant increase in employment and we had a reduction in unemployment. Our foreign trade has been strong, and there are signs that capital expenditures, which have been lagging in the recovery process, may soon be joining the recovery. I would say the recovery is proceeding quite satisfactorily.

You commented also on the President's energy program, referring to the $100 billion proposal. I am not qualified to judge whether we need $100 billion or $50 billion to develop new sources of energy. I can only comment with some authority on the financial aspect, that is, the financial procedures. I think that if any such program is adopted, whatever the amount is, whether it be $10 billion or $100 billion, it ought to be done directly through the budget. We started something in fiscal 1972 when we invented a new category called "off budget outlays." In fiscal 1972, the amount under that category was less than $100 million. For this fiscal year, the amount is over $14 billion according to the last figure I saw. It is growing. Now you can call these expenditures "off budget outlays" or "XYZ" or "abacadabra", but whatever you call it, this is money the Treasury has to go out and borrow like any other borrowings. I think good simple accounting procedure calls for including this item under the budget.

This off budget outlay category ought to be eliminated. Let us get it out of the system. It is a financial gimmick.

Now, as for the President's tax proposal——

Senator PERCY. Before you go on with the tax proposal, could you clarify the argument that is made that every company does this and they don't put through their borrowings, to build a factory or whatever—100 percent of the project. They capitalize through the profit and loss statement. What is the difference between the business of the Government and the business of a corporation?

I think it would be helpful if you would clarify for those who use that argument that backdoor financing cannot be looked on that way.

Mr. BURNS. Years ago I was in favor of a capital budget for the Federal Government. But I have seen Federal expenditures keep rising and I have seen State and local expenditures keep rising. At present, governmental expenditures at all levels account for 40 percent of the dollar value of our Nation's production.

In view of this explosion of Federal spending, if we went to a capital budget, I think spending would go up even faster. Therefore I have this basic reason for treating capital expenditures under the regular budget and not separating them out.

And certainly I would do away with the off budget category. I would do away with it promptly.

Senator PERCY. All right, sir. Thank you.

Now, the comment on the President's tax proposal.

Mr. BURNS. Well, I think that we would have a stronger economy if governmental expenditures were kept under better control. I think expenditures have been exploding on us. Thus I like very much the expenditure part of the President's program. I also favor a tax reduction to accompany the expenditure reduction. The only doubt I have is on the timing. I would want the two to be concurrent.

Senator PERCY. My last question pertains to the New York situation. If the Federal Government is to play a role, what would be in your judgment the correct route? Would it be a grant, a guarantee, or insurance for people holding the municipal bonds?

Mr. BURNS. I wish I could give you a confident answer to that. I believe at the moment that I would go the guarantee route, charging a fee for the guarantee, assuming that the Federal Government is going to legislate on this subject at all. And, as I mentioned previously, it is not clear to me that legislation is now desirable.

Senator PERCY. Because of the brevity of your answer, one quick question pertaining to your statement. You said that the Board will make funds available on whatever scale is needed to assure an orderly financial environment. You make that in the case of default by New York City.

I assume then you have made some assessment of the New York situation. How much money are you talking about making available if there is default?

Mr. BURNS. Let me interpret that phrase "on whatever scale is necessary." All that it means, and this is a great deal, is that our target for growth of the narrowly defined money supply, namely 5 to 7½ percent would be forgotten completely for the time being. We would permit that figure to bulge to almost any size for a time, in order to deal with the liquidity problem.

But before very long, Senator Percy, I assure you that we would pull back the reserves poured into the commercial banks, and try to get on a prudent monetary path once more. That is exactly what we did during the Penn Central crisis. Word then went out to the banks over the country that the discount window was going to be open and we would forget about our monetary targets. Within a short period we were able to get back onto our desired path. The net result was just a little bulge. We helped the financial system over a difficult period but did not distort our monetary policy.

Chairman HUMPHREY. Congressman Hamilton, I know Senator Percy was very grateful to you for yielding. You were most patient. Thank you.

Representative HAMILTON. Thank you very much. I appreciate very much your statement this morning, Mr. Burns. The last time I heard testimony on this particular subject in this committee was when Secretary Simon was before us on September 24. The thing that has impressed me today is the difference in tone between his statement on the 24th and yours today. He spoke at that time about the situation in New York City and said that: "A default would be primarily legal in nature." He stated that in his judgment it would be tolerable and a default would cause little, if any, damage to our financial structure.

As I understand it, even Secretary Simon now has moved away from his September 24 statement. I'm under the impression from your testimony this morning that you, too, have gone through a kind of similar odyssey; that is to say, that today you are much more aware of the risks to the economy of a default by New York City than you were a few weeks or months ago, and that you are much more receptive to the possibility of Federal intervention, but you have not yet quite reached the point where you would propose Federal intervention. Is that a fair statement?

Mr. BURNS. It is a very fair assessment except for the phrase "much more receptive." I still find myself in an unreceptive mood, but I no longer dismiss the idea. I recognize that the question that you are considering is a real one and that there is ample room for serious concern.

Representative HAMILTON. You said several times today that you have a lot of respect for the facts and you are going to be watching developments very carefully.

What kind of evidence are you looking for? What kind of things will be meaningful to you in making a judgment as to whether or not the Federal Government should intervene in some way to help New York City?

Mr. BURNS. It is my business to watch the economy and it is my business to watch financial markets closely, including the municipal market, the corporate bond market, the Treasury bond market, the money market, the stock exchanges, and the foreign exchange market.

Now this is my job. And I like to think that very few developments will not come under my scrutiny.

Representative HAMILTON. Well, of all the factors you mentioned, what would impress you the most? What do you look for when you try to make a judgment on this question?

Mr. BURNS. I cannot tell you with great precision what I would look for a week or two from now. What I look for particularly now is what is happening to new issues coming into the market: Are there bids? Who is doing the bidding? Are issues being withdrawn from the market? Is the inventory of municipal securities in the hands of dealers growing? What is happening to the yields?

These are matters that I follow almost hourly.

Representative HAMILTON. If you would reach the conclusion that a default by the city of New York would injure the economic recovery that is now in process, would that cause you then to support Federal intervention?

Mr. BURNS. Not necessarily. I tried to make clear toward the end of my statement that you still have to weigh a temporary cost to the economy against longer run national disadvantages or costs that may result from Federal intervention.

Representative HAMILTON. And your feeling today is that those consequences outweigh the benefits of Federal intervention now?

Mr. BURNS. That is my feeling as of today.

Representative HAMILTON. Thank you, Mr. Chairman, that is all.

Chairman HUMPHREY. Congressman Long?

Representative LONG. Thank you very much, Mr. Chairman.

Mr. Burns, I'm truly grateful to you. I'm truly gratified by your openminded attitude toward this problem and for the competence of your statement.

We all know cyclical problems with respect to recessions and their effect upon the cities and their more immediate effect upon the country at large. It raises in my mind the question as to what the effect would be if we do not continue getting out of the recession that we have found ourselves in? I wonder how much thought you and your staff have given to that and what the effect might be upon the recovery that we seem to be pulling out of, that we seem to be following, in the event that there is a default by the city of New York?

Mr. BURNS. I wish I could give you a precise answer to the question. This is my struggle. This is really your struggle, too. Unfortunately, this is not the kind of question to which anyone can give a very competent answer.

Some people will speak in strong and firm tones, but I can't. I recognize the limitations of my knowledge and my capability for foreseeing the future.

I recognize clearly—and I said so at a recent hearing of the House Budget Committee and I have elaborated on it to some degree in my testimony today—I recognize very clearly that a New York City default could injure the recovery process that is now underway.

Representative LONG. Would it include what recessionary aspects, I guess is the word, of the soaring bond market itself and the fallout from that insofar as capital improvements by cities and towns all over the United States is concerned?

Mr. BURNS. That is true.

Representative LONG. But neither you nor your staff have attempted to make any definite estimate with respect to the percentage impact on the gross national product or the dollar impact upon this?

Mr. BURNS. No, we have not done that because we have no way of doing it. This has to be, I am afraid, a question of judgment. I see no scientific way of arriving at an answer. I wish there were.

Representative LONG. I can well understand that it is very difficult to measure because once it starts that ripple effect, it might turn from a ripple into a tide effect. And once you start out, there is no telling which way it could go or how far it could go, is there?

Mr. BURNS. No; I'm afraid that is true. I do think, and I would emphasize this once again, I do think if Congress should be in the mood to legislate on this issue, I would very much hope you do so promptly.

Representative LONG. I'm sorry, you say you very much hope——

Mr. BURNS. That you will do so promptly.

Representative LONG. Promptly.

Mr. BURNS. Because the uncertainties inherent in protracted congressional debates will keep markets in a state of turmoil. At the same time, indecision by the Congress may keep New York authorities from doing what they otherwise might do for themselves.

Therefore, I believe an early resolution of this, whichever way you decide to go, would be helpful to financial markets.

Representative LONG. It is one of those situations where the indecision itself could perhaps be worse than the illness or what remedy is required?

Mr. BURNS. I think that is true.

Representative LONG. I'm inclined to agreed with you, but I have not really decided my own particular feelings with respect to what ought to be done in this matter.

I have done a serious reading and study of it and I have still not resolved it. I think I am in the position you are in. I'm not yet quite ready to recommend the Congress do it.

How would you resolve that if you were in our position? You say you are not yet willing to say that you would act, but if Congress does act, you are hoping for a prompt action on it or a prompt resolution of the problem.

Mr. BURNS. If I were a Member of the Congress, and if the vote were taken today on legislation that would render financial assistance to New York, I think I would vote against it.

Representative LONG. You would vote against it?

Mr. BURNS. As of today.

Representative LONG. All right. You might consider offering an amendment to put the United States in the position of a guarantor in the form of an amendment, might you not?

Mr. BURNS. As of today, a Federal guarantee is one of the things I believe I would vote against; but I don't want to go beyond today in my judgment.

Representative LONG. Thank you very much, Mr. Chairman.

Mr. BURNS. Let me add that I would respect thoroughly the thinking of the Members of Congress who might arrive at a different judgment if they were voting today.

Chairman HUMPHREY. Congresswoman Heckler, we are glad to see you here today.

Representative HECKLER. Thank you. Chairman Burns, I'm concerned about the already apparent consequences of the fiscal dilemma in New York City. We in Massachusetts have begun to feel the change in atmosphere.

Mr. BURNS. Yes, I noticed that.

Representative HECKLER. And as a matter of fact, the Massachusetts Housing Finance Agency has been trying to float a new bond issue and although this has been one of the highest rated securities in Massachusetts and the State legislature passed a bill putting the full faith and credit of the State behind the issue, nonetheless, buyers have not come forward. So that it seems that what appeared to be in the beginning a fiscal crisis for New York can well become a fiscal crisis for every municipality in the country.

Can we, with that kind of a forecast, afford to do nothing?

Mr. BURNS. That is a matter of judgment. I do think that, if the Congress decided to do nothing, New York would do more for itself.

Now that doesn't mean the Congress should decide to do nothing. This is a very difficult question and that is why you are holding this hearing. And that is why Senator Proxmire will be holding his hearing and also Congressman Reuss.

Representative HECKLER. Well it is a vicious cycle it seems. The Congress is doing nothing because they wish New York would do something for themselves and New York is wishing the problem would just go away.

Mr. BURNS. I don't know how you get around it, but one reason why New York has not done more to date is that the governmental officials within the city and the State have been encouraged to think that, one way or another, the Federal Government will come to the assistance of New York. I don't think there is the slightest doubt about that.

Yet, at the same time, the encouragement that has been given has come from well meaning men concerned with not only the welfare of New York City—and that is a very important part of our country, for after all New York is not only the financial capital of the country, but the financial capital of the world—but they have in mind the welfare of the American people as a whole.

I'm familiar with developments in Massachusetts with respect to this matter, and they haven't been good, even though I think your State has done a very considerable amount of work in putting its financial house in order.

Representative HECKLER. Well the Governor would be delighted to hear you say that.

I would like to ask what else do you think New York City could do for itself? What is it they could do that they haven't yet done?

Mr. BURNS. One of the difficulties is that New York City has done one thing today and undone the same thing the next day.

As far as New York State is concerned, it has created new debt instrumentalities. But New York State has not taxed itself in order to assist its largest city and to redeem the honor of New York. This hasn't been done. There hasn't been any real sacrifice, as I see it, at the State level.

To be sure, the credit of New York State has been imperiled in the process, but that is another matter.

Representative HECKLER. At this point, do you feel that the problems of New York, as serious as they are, are really just a temporary disturbance today, but eventually——

Mr. BURNS. This is the way I felt 3 months ago. I think it is more serious than that.

Representative HECKLER. Do you foresee other municipalities in the country reaching the same point of desperation that New York is experiencing today?

Mr. BURNS. I hear about other cities, but I know much less about them than I know about New York. I hear about other cities being in difficulty, which is not surprising in view of (1) the tendency on the part of our large cities to try to do too much, and (2) the recession which has reduced revenues and at the same time caused additions to welfare costs and other similar expenditures.

Representative HECKLER. In view of the increasing costs of energy, which don't show any prospect of diminishing, isn't it true that financial pressures on the city will have to rise?

Mr. BURNS. I think that is true. But it doesn't follow that the Federal Government has to assume the responsibilities. What it means is that we as a people are going to face certain burdens we haven't foreseen. We are paying a very heavy tax to the Arab sheiks. Not only that, the Arab sheiks may soon be in the position of being able to strangulate our economy.

I think this country is in danger. We are spending $90 billion on national defense, but that is money thrown out of the window if the Arab sheiks can close down our economy.

Representative HECKLER. That is indeed a serious pressure we face. However, if the Federal Government does not respond in the face of the fiscal crisis now in New York, how will we sell the Massachusetts Housing and Financing Agency bonds?

Mr. BURNS. Well, I don't know enough about Massachusetts. I do know that your State has moved in a fiscally responsible direction and I think your new Governor is to be congratulated. But I don't know enough about the details of Massachusetts' finances to comment beyond this.

Representative HECKLER. Yes; well I'm not concerned—well I am concerned personally with the Massachusetts situation, but I am concerned really with the national situation in terms of all the really disturbing bond issues. This happens to be one of the best offered in Massachusetts.

And when the Housing and Financing Agency, which is so acclaimed for excellent management and for being an outstanding investment, when that suffers, then what is likely to be the outcome nationally?

Now is this a temporary response? Is there a way to rebuild investor confidence in the bond market and at the same time allow a default in New York?

Mr. BURNS. I think that can happen. Of course, there is a risk.

Representative HECKLER. All right, one last question then. If the Congress should decide, and I don't think it is about to decide for I don't know how many Members other than New York State have actually made a final determination on this because it is a very serious question, but nonetheless if it seems the wisest course, is to take the risk in favor of assisting New York, then what do you think the wisest conditions for this assistance should be?

Should the potential legislation be related narrowly to the situation of New York? Should it be a short-term bailout? If so, how short? What conditions would you consider most sound under these circumstances?

Mr. BURNS. I commented on that previously and gave a rather lengthy answer. Let me give you what I think the critical conditions ought to be if Congress decides to move in this fashion.

First of all, the management of finances of the distressed city should be taken over by the State.

Second, the State should itself impose a tax that would meet, let us say, one-half of the prospective deficit of the ctiy over the next year or two, if that is the turnaround period that is decided upon.

Third, some Federal authority would have to lay down strict guidelines and approve this entire financing plan.

Now these are very stringent provisions, but there is a reason for it. The reason is that I think we ought to limit severely the number of municipalities that would receive financial assistance from the Federal Government. I don't think the Federal Government would want to involve itself in the management of city affairs on any large scale.

In saying that, I'm answering also your question about confining any legislation to New York. I doubt that you would want to do that. But if you did travel this legislative route and this is something I am not prepared to advocate today, I think you ought to limit severely the extent to which cities would be eligible for such assistance.

After all, no mayor of a city would like to have the State take over the running of the finances of his city, and no State would like to impose a statewide special tax in behalf of just one of its cities.

Representative HECKLER. On your third point, on the establishment of a Federal authority to set up guidelines for the financial plan of the city, do you think the Federal Reserve Board would be the appropriate authority?

Mr. BURNS. Oh, no.

Representative HECKLER. Even with your financial expertise?

Mr. BURNS. You know, sometimes when I'm asked where the responsibility for implementing legislation should go, I try to think of an enemy. And since I don't have any enemies in the city, I don't know to what address to send specific legislation. But please keep it away from the Federal Reserve.

Chairman HUMPHREY. Oh, Mr. Burns, it is wonderful to have you here. I don't know of any more delightful experience in my public life than having the chance to sit across the table from you. Even if I find myself in disagreement, I consider it a pleasure. And I mean that sincerely.

Doctor, you know, I just want to make an observation or two. I noted down here as you were visiting, as you were talking with us, as you were giving us counsel, that the debt of New York City is about twice that of all the liabilities of Franklin National, for example, which we were talking about earlier. So we are dealing with a very big item.

And the city budget of New York City is larger than the State budget. And when we are asking the State to sort of take care of the city, it is like asking the kid to support the parents.

Mr. BURNS. Not a bad idea. [Laughter.]

Chairman HUMPHREY. Well, if you can get them to do it, fine.

Mr. BURNS. It used to be that way.

Chairman HUMPHREY. Things have changed, Doctor, as you know. The thing that does concern me though is the capacity of the State of

New York to do much more than it has done. I am no expert in this matter, but from what I have read of late—and I have surely read a great deal about it—the strains upon New York State are upon it already in terms of its financing.

We also see serious problems that relate to the housing authority bonds in that State. They are having some difficulty on their marketings. Now we have the judicial—well I won't say interference, but injection of judicial decisions that are complicating the picture.

In your opinion, therefore, Mr. Burns, are there any actions that you can think of at this moment that the city and the State could take without Federal aid that could reasonably be expected to avert the possibility of a city default?

Mr. BURNS. The hour is late and investors are by no means convinced that New York City has gone far enough in bringing its expenditures under control. I think this is the nearly universal judgment of the financial community and investors—and never mind whether they are right or wrong—they are the fellows that put up the money.

The feeling about New York State is less clear. But certainly New York State is a rich State. Nobody likes to impose additional taxes, but I think a tax for a limited period, Senator, to redeem the State's honor would help the State. It would inspire confidence in the State. I must say this recent development of intertwining of State finances with the city finances has hurt the State's credit, which is very unfortunate.

Consider the notes issued recently by New York State. A very large amount is still unsold and the securities are moving very slowly. I'm not going to quote the interest rate or the yield on the securities that have been sold, but the yield is shockingly high. And so New York State has a problem of redeeming its honor, of restoring confidence in its own finances.

I think the special tax would help enormously to achieve that. Now that may be very difficult to achieve politically and I am expecting that. But yet, as you well know, just as the Congress will do its duty after much soul searching; so I think a State legislature would do its duty.

Chairman HUMPHREY. Well I think your point is well made, Mr. Burns, but after all cities are creatures of States. I mean there is a Federal structure we have and the structure of government is pretty clear insofar as where the responsibilities lie. New York State does face the possibility of a $600 million deficit already as a State government besides its normal financing of outstanding bonds and notes. So it is in a serious predicament.

I do not brush aside, however, your suggestion, but I want to note this so the record will be clear and the public will know. I am one of those Senators who will be before the Senate Committee on Banking chaired by Senator Proxmire. He has already asked some questions today that are very much relevant or pertinent to proposed legislation that I intend to introduce. I think it should be clear that none of us here who are interested in the Federal action, none of us are going to make it easy to get it. I do believe that there have to be very stringent and strict terms so that we do not open up a Pandora's box of fiscal irresponsibility, for we have enough of it already.

I think it is imperative that the standards be very precise. We welcome your counsel this morning on those matters.

I have been taking down notes, sir, to make sure that what proposal I do advance will at least come within the framework of some of your suggestions. I am also of the opinion that we are really off the beam here in the Congress by dealing with these matters, item by item. We bring up Lockheed, for example, and we have to judge whether or not we ought to have Lockheed.

Pressure is brought to bear upon members of Congress that you'd better vote for or against Lockheed. Interest groups are involved. And then we get Penn Central which is a perennial up here. I don't know who runs that outfit, but they are experts at bailouts. Then we will have others because once it starts, it gets a little easier, you see.

Therefore, I have always felt that we ought to have within the structure of our government, knowing these things do happen, some kind of permanent structure that can deal with them on banking principles and strict criteria rather than having Hubert Humphrey, who is really no expert in this business and I claim no expertise in it, coming up with just my idea or my concern. Maybe I'm considered one of those who is too liberal and they say I want to spend too much and so on.

So you have all the liability and all the human emotions and pressure. And I don't really feel capable of making the kind of objective judgment that you ought to make on these matters.

That is why I feel that somewhere in the Government there has to be a structure that deals with this kind of an emergency. Every hospital has an emergency room, you know, and you don't go around when somebody has an accident and say that we have to build an emergency room here, so we will have a meeting of the board of the hospital. But this is what we are doing here.

So, somewhere along the line, we have to come to grips with that. I say this in the presence of my esteemed colleague, Senator Proxmire, who I think can really put it together at the right time because no one knows more about it than he.

Now you said that New York City may not have done as much as it could to help itself and it is simply because there are some feelings that the Federal Government is going to come along anyhow. And what I said is to indicate to those friends of mine—and they are friends both political and personal—to not expect the Federal Government to be Santa Claus, but you can expect us to at least be cognizant of the seriousness of the situation and hopefully to be responsive in a manner that is responsible. That is my objective at least.

And I am concerned, might I add, doctor, about the monetary policy that we might pursue in light of some of the developments that seem to be underway. You have outlined for us at least as a possibility and a probability not only of default of New York City—and that is not necessarily a possibility but a probability—but also the difficulty of New York State.

And it has already been demonstrated that some of the negotiable instruments that are out there, some of these securities and bonds, have already lost value of as much as 10 percent. Now you stated that the Federal Reserve would make available some sufficient funds—and I won't say unlimited—but sufficient funds through the discount window to both member and nonmember banks in order to assure an orderly financial environment.

May I say I wish the Secretary of the Treasury was as concerned—and I say this and I know it sounds like I am being personal and I don't like to be personal because I like Bill Simon personally—but I wish he had the same feeling about the structures of government as you have about the structures of the bank, Mr. Burns, because when you wrote to me, I understood that you were going to see that the banking system of this country was in place and was not jeopardized. So I understand why you did what you did with Franklin National. It was distasteful, but it had to be done. I said that before. I said there is no use going around spanking people and giving them more lectures on morality. It just had to be done.

Now what happens to this monetary policy if the State of New York and its agencies would have to in some of their bond issues go into default on their obligations? Wouldn't the magnitude of bank borrowings be further increased by the significant decrease in the value of outstanding municipal bonds plus the possibilities?

Then I have to ask this question. How significant a bulge in money supply would you anticipate as the result of these unlimited credit extensions through the discount window in order to cover all of this? Because the real truth is it ultimately gets back to the banking structure. That is where it ultimately gets back.

Could you give us any idea of what you foresee? This is why I wanted to kind of get you in the act before the deluge hit you, Mr. Burns. I thought we would build a couple of upstream dams, you know.

Mr. BURNS. The Federal Reserve, under the congressional concurrent resolution, is now announcing its guidelines for monetary policy. The only answer I can give you, Senator, is that if something approaching a financial crisis were to take place, our monetary targets would just go out of the window completely.

Chairman HUMPHREY. That is my thought.

Mr. BURNS. Completely, and we would see to it that banks in our country had the cash that they needed and that there was no credit crunch in the country.

This would create a problem for us because we do have a certain responsibility for keeping the supply of money within reasonable bounds.

However, I would expect that with such energetic action on the part of the Federal Reserve—and we wouldn't lose an hour, I can assure you—that any such crisis would be very short-lived, that things would soon calm down, and then we would pull back the reserves that we would have created.

How successful we would be in that exercise I cannot be sure, but I am reasonably confident that we would be able to manage it.

In the Penn-Central case, we did exactly this thing. The monetary targets went out of the window. The banks were invited to come in and the discount window was opened.

Within a short time, the crisis was resolved. So we began pulling back the reserves that we had put into the banks, and we were back on our basic monetary path in a few weeks.

Whether we can do as well in the event of a crisis set in motion by a New York default, I cannot be sure. But I am confident that we would be able to manage.

In any event, the money targets would just go out the window. Other people would be paying attention to them: The statisticians, maybe the bankers, the commentators, but I wouldn't. The thing to do is to keep our system working. There must be no credit crisis in this country. I'm quite sure we can prevent one, because our resources are enormous and we would put them to work.

Chairman HUMPHREY. Mr. Burns, that is a very reassuring statement. It should be reassuring to the public and investment community. I have often been critical of banks and bankers. I guess it is because of my background and you'll have to forgive me for it, but having grown up in the period of the Depression and with what I witnessed in those days, it is hard to erase it from one's memory, from one's political or intellectual makeup or however you wish to put it. But I have never believed that we ought to put all the responsibility for salvation upon the banks. That is why I think there are some things we maybe ought to do ourselves. I think that we try to put on the banking structure too much control of inflation and I think we tried to put on them too much control of everything. So that is why I asked the question. But your answer is very reassuring. I just hope we don't get to that point, Doctor.

Now I'm glad you said you are making your judgment on the basis of facts as of today because it is my own personal feeling that the facts a week from now may not be as pleasant as they are today. I may call you up on the telephone, old friend, and let you know.

Mr. BURNS. You know perfectly well how delighted I would be to hear from you.

Chairman HUMPHREY. I know that and I know what you will be going to say. Thank you.

I tell you, Doctor, you are so disarming. Would you like to negotiate a disarmament treaty with somebody? [Laughter.]

Senator Proxmire.

Senator PROXMIRE. Just a couple of loose ends I would like to clear up if I could. You put a lot of emphasis—and understandably so—on New York imposing a tax that would cover half the deficit. I'm a little bit unsure as to what deficit we are talking about. There is an operating deficit of about $700 million and an obligational turnover of about $2.8 billion on obligations that are coming due over the next 6 months or so. Are we talking about the $700 million operating deficit or the obligations?

Mr. BURNS. I understand the deficit is larger than that and that it is in fact a little over $1 billion. But whatever the magnitude may be. I had the operating deficits in mind.

Senator PROXMIRE. The operating deficit? Well now I understand that New York State's budget is about $10 billion. So presumably that would be about a 10-percent increase in taxes, is that correct?

Chairman HUMPHREY. Five percent.

Senator JAVITS. Five percent.

Senator PROXMIRE. I stand corrected. The operating deficit would be about 10 percent of their budget and the tax that you propose would be about half of that, or 5 percent, is that correct?

Mr. BURNS. Correct.

Senator PROXMIRE. Now there has been some talk about the RFC. I have here the final report of the RFC. It is interesting in a number of respects.

The Reconstruction Finance Corporation made loans to public bodies, as you may recall, with great success. In fact, in the Depression, they loaned about $400 million to public bodies, which of course in present terms would be several billion I presume. Their repayments were better than in any other category—their loss experience was better. Their losses were less than 1 percent. In other categories, losses were much greater. At the same time the kinds of loans they made were quite different than what we are talking about here. These were loans that were made to—I will give you some examples.

For large projects: $136 million authorized to the State of Arkansas Highway Department; $37 million to the Pennsylvania Turnpike Commission; $20 million to the Philadelphia Gas System; $28 million for the Cleveland Transit Authority.

So these were not to assist the municipalities that were having overall fiscal trouble, but to provide assistance so that job creating projects would move ahead. Nevertheless, there is some analogy here.

In view of the fact that we had this profitable experience with RFC, and that was in a period of economic difficulty, as we are undergoing now, and in view of the fact that a great deal of the difficulty of New York is because of the recession—in my view they probably would not be in this difficult position if it weren't for this very serious recession—do you under these circumstances see that we might have something like an RFC or seriously consider it or do you think it wouldn't be appropriate?

Mr. BURNS. I have worried about that a great deal. I have drawn contingency plans. I think the world is different that it was during the 1930's. These days many of us are critical of trade unions. I know I have been. They have abused their power in various situations; for example, in the construction industry where you have unemployment in the 20-percent range. But we tend to forget that the mentality of the business and financial communities has also undergone a profound change over the past 40 years. Businessmen have acquired the habit of running to Washington when they have a problem.

I'm not going to give you any names, but I had very prominent bankers come to me 9 months ago or 6 months ago and urge my support for an RFC because they were having problems with their real estate investment loans. But suppose Congress had established an RFC to assist the banks and others, what would have happened? What would have happened is that the banks would have unloaded onto the RFC their dubious loans—all at the taxpayers' expense. Now, as it is, we have no RFC and the banks are working out their real estate loans, their weak loans. They are grumbling and they are unhappy, but they are still making good progress and the taxpayer is not burdened.

So the time may come when we need a new RFC, yes; but I would just like to watch my step. The mentality of businessmen is quite different than it used to be. We still talk about free enterprise, and the rhetoric is just as good as it ever was, but the practice is by no means as good. Many of these so-called free enterprisers do believe—and I am going to use this word, Senator Javits—do believe in a bailout of private business or banks. I personally don't like it. I think that the free enterprise system involves taking some risks. If you make bad judgments, you ought to suffer the consequences.

Senator PROXMIRE. Of course, we are talking about free enterprise——

Mr. BURNS. No; let me say, there are limits to that.

Senator PROXMIRE. You referred to the Lockheed loan. I did my very best to stop it, as you may recall.

Mr. BURNS. I was for it and you were against it. You lost by one vote. You were right and I was wrong.

Chairman HUMPHREY. And I was the one vote. [Laughter.]

Senator PROXMIRE. Now, in this case we are not talking about assisting a business. We are talking about assisting a public body. Are you concerned about the prospect that if New York does default, if New York State gets into very serious difficulties, then we might be a long way toward an RFC? And an RFC might then, as Senator Humphrey so persuasively said, be a very appealing instrument rather than having the Congress trying to settle each one of the problems as they come up on an ad hoc basis so that we would have an expert agency, a Government bank, move ahead and do it.

Wouldn't the default of New York, if we don't act to prevent it, wouldn't that hasten that possibility?

Mr. BURNS. It could. I wish I could give you a clearer reply. I just can't.

Senator PROXMIRE. Well, thank you; thank you very much. Thank you, Mr. Chairman.

Chairman HUMPHREY. Senator Javits.

Senator JAVITS. Thank you, Mr. Chairman. I have not been here for a while due to the gun control legislation upstairs. We had a hearing at the same time as this hearing. But I do think, Mr. Burns, you have offered us your usual very wise, extremely well-informed advice. I am very glad of one thing, Mr. Burns; you show a flexibility in respect to your thinking based onw hat the market delivers. Do you agree that the last 2 weeks has already been an indication that this is by no means a static situation? And we may be seeing dangers which will be recognizable as within the parameters of the requirement of Federal aid sometime between now and the turn of the year?

Mr. BURNS. I have no quarrel with that statement, Senator.

Senator JAVITS. Fine. Thank you very much.

Chairman HUMPHREY. Mr. Burns, this has been one of our better hearings from the point of view of good discussion. Surely I think your statement is one of the most significant that has been given before this committee. We thank you very, very much. I am sure you know that I still am one who, despite your feelings today, feels that there is some responsibility here at the governmental level; but I have learned a good deal, I have taken notes of what you had to say, and I especially want to thank you for arranging your schedule to come here. I know it was not easy. We are honored that you gave us this attention.

Thank you very much and have a good lunch.

Mr. BURNS. Thank you very much, Senator.

Chairman HUMPHREY. The hearing is adjourned.

[Whereupon, at 1 p.m., the committee adjourned, subject to the call of the Chair.]

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