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STATE AND LOCAL GOVERNMENT CREDIT PROBLEMS

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

NINETY-FOURTH CONGRESS

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CONTENTS

WITNESSES AND STATEMENTS

FRIDAY, JUNE 20, 1975

SUBMISSIONS FOR THE RECORD

FRIDAY, JUNE 20, 1975

STATE AND LOCAL GOVERNMENT CREDIT PROBLEMS

FRIDAY, JUNE 20, 1975

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

The committee met, pursuant to notice, at 10:10 a.m., in room 1202, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (chairman of the committee) presiding.

Present: Senators Humphrey, Proxmire, Javits, and Percy.

Also present: John R. Stark, executive director; Loughlin F. McHugh, William R. Buechner, Jerry J. Jasinowski, L. Douglas Lee, and Ralph L. Schlosstein, professional staff members; Michael J. Runde, administrative assistant; M. Catherine Miller, minority economist; and George D. Krumbhaar, Jr., minority counsel.

OPENING STATEMENT OF CHAIRMAN HUMPHREY

Senator HUMPHREY. The committee will come to order.

I'd like to welcome our witnesses and express our thanks to them for taking the time to come and share their thoughts with us. Senator Percy, very shortly I will have you present the Governor.

Today the Joint Economic Committee will hold a 1-day hearing on the financial problems of State and local governments. This hearing will focus first on the budget difficulties that most State and local governments are currently experiencing; and we will then discuss in detail difficulties that many State and local governments are encountering in the credit markets.

The financial problems of State and local governments have rightfully received increasing attention in the last few months. Victimized by the severity of the current recession many State and local governments have been forced to undertake economic measures to keep their budgets in balance.

I want to emphasize that State and local governments are, by constitutional provision, or by statute, forced to take these budget actions because 45 States have specific constitutional or statutory provisions that require State and local governments to operate with balanced budgets. This is a point which is not often understood by people outside the State and local governments.

A recent survey undertaken by this committee shows that State and local governments have been forced to undertake almost $8 billion in budget adjustments; $3.6 billion in tax increases; $3.3 billion in cuts of current service levels, and approximately $1 billion worth of delays in capital construction. These cutbacks have a significant adverse impact on the Federal Government's efforts to stimulate the economic recovery with tax reductions and with the addition of public works; and even a more serious impact on the ability of State and local governments to maintain adequate services through the recession when the need for services is greatest.

Although these budget adjustments are indeed significant, they mask far more severe problems in cities and States that already have the most severe unemployment problems.

The problems of our Nation's largest cities are certainly well documented. But this crisis situation is not confined to New York City. Hiring freezes and layoffs, cuts in services, delays in capital expenditures and increases in taxes are the rule, not the exception. Most of our Nation's largest cities have already been forced to take one or more of these actions.

Cleveland has been forced to lay off 1,100 workers, and cut back services to a level that previously would have been unacceptable.

Detroit, as I am sure Mayor Coleman Young will tell us, has had to lay off about 1,500 workers, and cut back essential services.

Buffalo, N.Y., is facing a $50 million deficit this year.

These problems are not confined to our largest cities. Wilmington, Del., has had to reduce its firefighting force by 11 percent, and other city departments have experienced cuts as high as 40 percent.

An informal telephone survey, conducted by the National League of Cities of 67 small and medium-sized cities indicated far more widespread problems. One-third of the cities in that survey had cut payrolls by laying off employees, or through a combination of hiring freezes and attrition. Over one-half have postponed essential capital expenditures. Two-thirds found their revenues have fallen short of anticipated levels; and almost half expected to enact some form of tax increase in 1975.

While these budget problems that State and local governments are currently experiencing are indeed severe, they are often accompanied by difficulties of even greater proportion in the credit markets.

Last year the interest rates paid by State and local governments soared along with other rates as the Federal Reserve tightened the monetary screws. Many of these governments were forced to delay or cancel issues, or issue only short-term securities. However, while interest rates for other long-term securities have declined slightly earlier this year, yields on State and local government securities have actually continued to rise. In fact, according to the Treasury Bulletin the average yield of long-term AAA tax exempt municipal bonds rose to a high of 6.85 percent in April, while the yield on AA corporate bonds actually declined one-half of a percentage point since last October. AAA municipals have taken a one-half percentage point leap in the opposite direction.

Despite these relatively more attractive interest rates that tax-exempt securities are offering, the market has not been overridden by buyers. In recent months, banks and fire and casualty companies, which were the backbone of the tax-exempt markets, have shown a real reticence to purchase new municipal tax-exempt issues.

We hope to examine this phenomenon today, and attempt to understand the factors which are causing their exit from the market. It is particularly important that we understand whether this retrenchment on the part of the traditional purchasers of tax exempt securities is a permanent development, or a part of the current business cycle.

In addition, it is important that we understand what are the appropriate uses for the tax-exempt market. In recent years tax-exempt securities issued by private corporations have taken up a larger and larger share of the tax-exempt market. While the purposes of these bonds are certainly worthy—pollution control and industrial development—they do compete with and crowd out cities and States that have traditionally been part of the tax-exempt market. This problem warrants careful study and will be examined today.

Finally, we will examine the recent difficulties that New York City has experienced in the credit market. These problems are of course important to New York, but they also have a devastating effect on other cities in the credit markets. Just yesterday an article appeared on the front page of the Wall Street Journal [1] describing the impact of the New York City problem on the rest of the tax exempt market. The article points out that, "Jittery investors, with an eye on New York City's most recent brush with default, are beginning to avoid bonds and notes of large cities like the plague. Particularly affected by this new skepticism are the large urban centers in the declining regions of the country that can least afford to pay the premium interest costs."

We are fortunate to have with us today four distinguished witnesses to discuss these important financial issues. Our first witness is the Honorable Dan Walker, Governor for the State of Illinois, and he will be introduced by Senator Percy. Our second witness is the Honorable Coleman Young, Mayor of the city of Detroit. And we also have Mr. Lennox Moak, budget director of the city of Philadelphia, and Mr. Gedale Horowitz, a partner of Solomon Bros.

Senator Percy, we look to you now.

Senator PERCY. Thank you, Mr. Chairman. It is a great personal pleasure for me to introduce to this committee, on which I have served for 9 years now, the distinguished Illinoisan who with his 49 colleagues in State houses around the country is on the front line of the battle, the fiscal battle of State government.

Governor Dan Walker came to public service from a business background. He was vice president and general counsel of Marcor, one of our great Illinois and American corporations; and director of both insurance companies and a bank. And I might add, Mr. Chairman, I am very proud that Marcor and its subsidiaries, Container Corp., Montgomery Ward, and others, is in the forefront of those companies which endorsed the bill that you and I have cosponsored and worked so hard to adopt, the Consumer Protection Agency bill.

In fiscal year 1975 Governor Walker presented a budget that was not free from criticism or controversy, but it actually projected a budgetary balance of $125 million, a phenomenon virtually unknown here in Washington. Economic setbacks have now reduced that figure to an expected surplus—a surplus of $120 million.

Now, however, the Governor maintains that his fiscal year 1976 budget, introduced in March, must be cut at this stage by 6 percent, as much as $300,000, to remain in balance, or taxes must be increased, a very difficult undertaking in a recession.

I am sure the Governor will provide us with interesting insight in the problem of financing State and local governments in a recessionary period.

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[1] See article, beginning on p. 20.

On behalf of this committee I wish to welcome Governor Walker to Washington, and thank him for being here and participating in this very important hearing.

Mr. Chairman, if I might be allowed a moment of personal privilege. Last night my brother-in-law returned from about 6 years service abroad with the Peace Corps. You and I have been among the strongest supporters of the Peace Corps in the Senate of the United States.

He is here in this room today with his wife, Diana, and three boys, Brooks, Steven, and David. For 3 years he served in Bombay as head of the Peace Corps in that region of India. Then for the last 3 years, as Director of the Peace Corps in Afghanistan, providing very distinguished leadership for hundreds of our Peace Corps Volunteers.

He returns today to this country with his family and I feel certain that he, like other Peace Corps members, will make a much more valuable contribution and appreciate this country, as he just told me last night, more than ever before.

I can't but say how proud indeed I am of a brother who has seen fit to leave a fine business on the west coast and go abroad, and undertake this responsibility for these years. I am very proud to have him here today, and to have here my distinguished Governor.

Chairman HUMPHREY. I am very pleased, Senator Percy, that you made this introduction of your brother-in-law and his family. He has a fine record of service in the Peace Corps and we welcome him here.

I take great pride in having authored the Peace Corps bill when I was a Senator here in 1961. I feel it is one of the finer achievements, may I say, of my public life; and Senator Percy has been its most avid supporter on the Committee on Foreign Relations.

Governor Walker, we welcome you; and Mayor Young, we welcome you. Governor Walker will speak first, and Mayor Young will follow him immediately. I understand that you do have to depart rather early. And if the Governor will bear with us, after the two presentations we will question the Mayor, and then come back to you, Governor.

Governor Walker, please.

STATEMENT OF HON. DAN WALKER, GOVERNOR, STATE OF ILLINOIS

Governor WALKER. Mr. Chairman, Senator Humphrey, and Senator Percy. I thank you, Chuck, for the introduction.

I would like to thank this committee for inviting me to be here today. Your invitation and the chairman's opening remarks reflect properly your very deep concern about the financial situation of State, and local governments.

I have filed with the committee a prepared statement, Mr. Chairman that I would like to, if I may, just highlight.

Chairman HUMPHREY. We will include your entire statement in the record of your testimony.

Governor WALKER. Thank you.

In a sentence or two summary, we have been seriously affected by the recession, as the chairman has pointed out. Our revenues are not meeting expectations, and demands for additional services for the victims of recession are increasing.

To be more specific, when our fiscal 1976 budget went to the printer in February, we estimated State revenues on the basis of a projected 5-percent decline in real gross national product. Like everyone else's, our estimates were wrong. As you know, the real gross national product declined by more than 11 percent in the first quarter of calendar year 1975.

We now anticipate that our revenues for this fiscal year and next will be $140 million less than our budget anticipated. As welfare and other costs rise, the result is an unprecedented squeeze—the word "vice" might be more accurate—on the financial resources of the State.

And we have another problem. During the years of prosperity, a lot of States, including ours, undertook new and vitally needed programs, and I would like to cite two in Illinois.

We established in Illinois a new Public Transportation Authority for the Chicago metropolitan area to help bail out a financially troubled public transportation system in the city of Chicago. This will cost the State over $160 million just in 1976. Even more serious is the educational pressure where we have formula-driven annual increases. Our State now provides well over $1 billion, or about 45 percent, of the total cost of elementary and secondary education in Illinois. The large increases in funding for education by the State have helped local communities such as Chicago, to hold the line on local real estate taxes, and make rollbacks in taxes possible in some areas of the State.

Our school enrollment, in many districts, is stabilizing or dropping. But the educational bureaucracy, particularly in the middle management area, continues to grow. The pressure for increases in educational funding is just as intense today as it was in the days when schools were underfunded.

The second major driving pressure is welfare. In Illinois, unlike some other States—like New York, for example—the State is paying practically all of the non-Federal cost of welfare; the cities in Illinois pay nothing. In addition, our support for local governments continues. About 35 percent of our total State budget goes directly to local governments in grants and revenue sharing from income tax receipts.

With all of these driving pressures on spending, it doesn't take anyone from the Brookings Institution to realize what the alternatives are for State government; either cut spending, or increase taxes. Twenty States, I am informed, are now considering increased taxes.

I have chosen the other route, to cut spending.

As Senator Percy mentioned, I have proposed an average 6-percent reduction in all appropriations in all branches, departments and agencies of State government. The only exceptions that I would allow would be fixed expenses, like debt service, which obviously you can't cut; and the current level of welfare grants which I will not cut in time of recession; and elderly tax relief, which is very, very important right now.

I rejected the tax increase approach for several reasons. I think that a tax increase at a time of recession is bad economic policy. And to the ordinary taxpayer out there, when he sees the Federal Government decreasing taxes and the State increasing taxes, that person can only conclude that "Government doesn't know what it's doing and what's more doesn't care about me."

Unfortunately the effect of increased taxes would be to cancel out at the State level a good part of the economic benefits that flow from the tax decrease by the Federal Government.

Senator, delighted to see you this morning.

Senator PROXMIRE. Thank you, Governor Walker.

Governor WALKER. It would also be, I think, also very unfair to the already overburdened taxpayer who has tightened his belt to the point of real pain. And I have said over and over again, if people can find ways of tightening their belts, then so can government.

When inflation was the Nation's chief economic headache—and it was in our State, too—we worked very hard to control spending, to hold the line on spending. I initiated management controls such as zero based budgeting, and management by objectivity. We actually, in Illinois, in the first 2 years of my administration, reduced State employment by about 5,000 jobs, 8 percent of the total number of State employees under my jurisdiction. And in my first budget, the fiscal 1974 budget, we held appropriations to the fiscal 1973 level. I felt at that time that the State should not be contributing to inflationary pressures through large increases in public spending.

Then came the recession. When unemployment began to increase, I reversed the tight controls on capital spending. I proposed a $2 billion construction program—we called it the Accelerated Building Program—in the hope that we could put more money into the private sector to help stimulate the economy and provide jobs, particularly in the construction industry.

That program called for undertaking new capital projects that we would do in the normal course of time anyway, and do them this year and next year. We would have generated considerably more revenue for the State, and we would have provided more than 60,000 direct and indirect jobs in Illinois.

We also felt that in the long run we would save money for taxpayers by paying at current rates rather than inflated rates years from now. That is, if we built now, we could do the job more cheaply than 5 years from now. And the bonus would be jobs for the unemployed.

Now, I want to stress that this program emphasizes what we call short leadtime projects. The entire program would have been bond financed, half through general obligation bonds, and half through revenue bonds which do not directly obligate the State. We felt—and I am convinced this is accurate—that these bonds would not have hurt Illinois' AAA rating, and that the debt service could have been accommodated without any tax increase.

Unfortunately the Illinois General Assembly disagreed with me, and just a few weeks ago decided to kill the accelerated building program.

As I shall mention later, Senators, I remain hopeful that Federal funds will be made available, so that we can proceed with many of these short leadtime building projects that were contained in that program.

And this leads me to the key role that I think must be played by the Federal Government. If I could suggest some directions, it would be these:

No. 1 is an obvious one that I know you have already expressed concern about. It is very important to State and local governments that the Congress reject deep cuts in social service programs. When the Federal Government makes those kinds of cuts, either we must pick up the program, or drop the service. And as you know, many times the latter course is virtually impossible.

There is also a desperate need for the Federal Government to provide money in the construction area. And what we need particularly is the kind of help provided in the recent Highway Act, where matching fund requirements are deferred, and States are given flexibility to use the money for short-leadtime projects instead of long-leadtime projects.

Just to give you an example. With the Federal funds provided in that act, we in Illinois are going to be able to proceed with a vital highway safety program that includes widening and resurfacing literally hundreds of miles of narrow, dangerous roads. And within a matter of weeks we are going to be out there, spending that money, providing jobs.

I would like to suggest two areas where Federal construction money could play a very important social role in our State. Our accelerated building program included a series of smaller centers, in communities around the State, for the mentally retarded, or what we call the developmentally disabled. Those persons right now, as you know, are mostly in large institutions far away from their homes. Our plan calls for the State to build small live-in centers, and then turn them over on a turnkey basis to communities and mental health groups.

The Federal Government could provide funds to build these centers at relatively low cost—and this is important—without incurring built-in commitments to fund the operation of the centers. This can be done with the assistance of grants that we provide at the State level.

And in Illinois we could go, we could be building these kinds of centers this summer and this fall.

Another section of the accelerated building program calls for the construction of 135 new schools. Now, under some legislation now pending in Congress, such as the new proposed public works bill that I know you are working on, Mr. Chairman, we could move ahead rapidly on projects like these.

Now, one problem we face—and I want to stress this today—one problem we face in accelerating construction projects such as those I have mentioned is the bureaucratic redtape frequently imposed by Federal agencies. Too frequently restrictions and regulations either slow projects down dramatically, or add very significantly to the cost of the projects. I don't know about other States, but I do know that, in Illinois, for example, in large part because of Federal regulations, it now takes us 7 years to start building a proposed major highway, that is, in large part, the result of Federal regulations. And the same problem exists with respect to the federally funded pollution control projects. Months, months go by while plans that have already been reviewed and approved at the State level are reviewed, changed, and re-reviewed again at the Federal level.

On another subject, the concept of Federal countercyclical assistance to State and local government, I believe, has very much to commend it. Currently State and local governments tend to expand spending during inflation, and to cut back during a recession. I personally think it should be the other way around.

For this reason, I fully support the much-needed Intergovernmental Recession Act of 1975.

One other area I would like to touch on. Communication and cooperation between the Federal Government and State and local governments, fortunately, has improved substantially in recent years. There are now procedures for consultation with State and local governments in the Congressional Budget Reform Act. The Federal executive branch is also consulting with State and local officials; and the requirement of inflation impact statements of Federal actions on State and local government budgets, I think, is a real step forward.

In conclusion, gentlemen, I want to stress that I am not here to suggest that the role of State and local governments is confined to standing in line and waiting for a Federal handout. I do believe that Federal funds can appropriately be made available in the areas that I have mentioned.

But at the same time State and local governments have a real responsibility to weigh the impact of their spending on the economic situation that exists in the country regardless of whether their revenues are increasing, or decreasing. State and local governments account for about two-thirds of total public spending in this Nation; and our responsibility, which we must shoulder and must carry out better, is to do a better job of controlling that spending.

Thank you very much.

Chairman HUMPHREY. Thank you very much, Governor Walker. Your prepared statement will be included in the hearing record.

[The prepared statement of Governor Walker follows:]

PREPARED STATEMENT OF HON. DAN WALKER

Mr. Chairman and Members of the Committee: I am happy to appear here today along with fellow Governors and Mayors in response to your Committee's concern about the financial situation of state and local governments. It is commendable that this Committee is going out of its way to solicit first hand testimony on what is happening in our states and our cities.

The words "crisis" and perhaps even "disastrous" best describe the financial situation of many state and local governments.

The only reason we have been able to balance our budget this fiscal year is because the state over the last two years nurtured its resources and developed a substantial surplus by a combination of prudent financial management and inflation driven revenues. We have worked hard in the past two years, for example, to reduce governmental costs through such management techniques as zero base budgeting, management by objective and reduction of a padded state payroll by approximately 5,000 employees.

When we prepared our FY 1976 budget in February of this year, which went to the printer in late February, we knew that the recession was going to hurt us—both by reducing our revenues and by increasing the number of people who need helip. Using sophisticated econometric models, we anticipated a modest five percent ncrease in revenues. Instead, we, like everyone else, were hit by an 11 percent plus decline in the real Gross National Product in the first quarter of 1975. At current forecasts—we will have $140 million less than we anticipated at the end of Fiscal 1976.

Like 35 other states, Illinois has a constitutional mandate that our spending not exceed our resources and we are prohibited by the state constitution from deficit spending.

We have had to revise our revenue estimates downward for both this fiscal year and the next, making it essential to do something about spending. The solution, recommended in a special message to our legislature last week, is a 6 percent across the board cut in appropriations. Everything—every department, agency, commission, every constitutional office, each branch of government (except for a few items such as debt service that cannot legally be reduced) the level of welfare grants and tax rebates to the elderly—is subject to the across the board cut.

I do not like making these cuts. They are, after all, reductions of what I believe are desirable expenditures in the areas of elementary and secondary schools, mental health and higher education. For the most part, despite the 6 percent across the board cut, we will be funding state programs—such as education—at a higher level than last year.

The alternative, however, is worse. I am against any tax increase. It is wrong to impose new state and local taxes at a time when a record number of our citizens are unemployed and many families have already seen a decline in their real standard of living due to inflation. If people have already tightened their belts to the point that it hurts, then state government can and should do the same.

First, it is an inappropriate policy to increase taxes in a time of recession.

And it is both wrong and counter productive for state and local government to increase their taxes when the federal government is reducing theirs.

Local tax increases would wipe out the intent of the federal tax cut. Yet, because of the economic situation, many states, I am told, are doing just that—increasing taxes.

According to a report on state and local finances prepared for this Committee, state and local governments will have to increase taxes by over $3.6 billion this year to balance their budgets. If the intent of the federal tax cuts was to stimulate the economy, these state and local tax increases will cancel out some of this stimulation and slow even more the long-awaited economic recovery.

And when state governments are in fiscal trouble, there is a significant impact on local governments as well. In Illinois, almost one-third of our budget is devoted to grants to local governments. Through a new school aid formula, we will provide about 45 percent—almost one billion dollars of the total cost of elementary and secondary education. This support has prevented substantial increases in local property taxes. In fact, we channel our entire federal revenue sharing allotment into aid to local school districts.

In Illinois, we have a special program of revenue sharing which allocates one-twelfth of our state income tax receipts to local governments. Local governments will feel that loss directly. We have a similar program for our gasoline tax to fund local road repairs and improvements.

We have inaugurated extensive programs of state aid to public transportation programs, not merely to the new Regional Transportation Authority in metropolitan Chicago, but to downstate transit districts as well. The state provides the largest amount of support—well over $100 million—to the authority outside the fare box.

Unlike New York State, the State of Illinois bears the entire non-federal costs of welfare and social services.

Obviously, when the federal government takes action to reduce its financial support in vital state programs, it hurts not only the state, but local governments and, most important, the people who depend on us for support. When these negative federal actions come in time of recession, they compound our problems in meeting the needs of people.

During the coming fiscal year we will be paying the full costs of inflation on the expenditure side at the same time that we are feeling the devastating effects of recession on the revenue side. In effect, we will be paying inflation costs with recession dollars.

It is very difficult to follow prudent fiscal management in the face of business cycles. When the economy is overheating, revenues increase more than expected creating a very false sense of inexhaustible dollars.

Despite unanticipated revenues, we made a vigorous effort to hold down the rise in state spending. These efforts often encountered difficulty in the face of strong pressures for substantial spending increases in current state programs which built up not merely larger budget bases, but expectations of future increases. When recession cuts down on our available revenues, the pressure of this spending from times of prosperity create serious financial problems for state government.

What can the federal government do to help state and local governments in the immediate fiscal crisis? How can these crises be avoided in the future? I have some suggestions.

First of all, the Congress and the Executive Branch must restrain themselves from making our problems substantially worse than they already are. The impact of the President's FY 1976 federal budget on state and local governments would have been ruinous. That budget would have reduced federal cost sharing for social services and for AID to Dependent Children and Medicaid programs. It would have reduced federal commitments to ongoing programs in other areas, particularly health services.

These changes would have cost Illinois over $100 million. And they would have forced us either into additional cuts in services provided to people hurting from the recession, or raiding resources of other state-funded programs to sustain federally-aided programs. Fortunately, Congress imposed a more humane wisdom.

Second, the federal government can accelerate capital spending. If construction spending can be coordinated with state capital spending, short lead time projects can be started and can have an immediate and positive impact on the economy, particularly on unemployment.

Federal bureaucrats have the tools to wreck havoc on our state and local programs. They wield enormous power with little or no accountability—to you or us—for the human and governmental consequences of their actions. Federal red tape frequently prevents us from taking those actions needed to combat economic emergencies and to meet the human needs the emergencies create. If state and local governments are to be able to respond to people's needs, the avalanche of twisted red tape must be cleared away. Bureaucratic insensitivity must be subordinated to the broader human needs we must all serve.

If federal money were available and if the bureaucratic red tape were cut, Illinois could put hundreds of millions of dollars in construction projects under contract this summer for school construction and rehabilitation, mental health facility construction, park and recreational improvements, public transportation facilities improvements and highway and other road repairs. These projects would create millions of dollars in new payrolls and general local and state tax revenues, in addition to meeting vital social needs.

One of the most useful things the federal government has done is the recently passed legislation allowing the states to defer payment of matching funds for highway construction. This decision, for which I wish to thank the Congress, is allowing states to maintain major road construction programs in the face of stagnant and declining gasoline tax receipts.

Third, a state and local fiscal crisis is a money problem that admits of a simple solution: money.

General revenue sharing should be renewed and quickly. If uncertainty about renewal begins to build, some jurisdictions will begin to hold back on spending to cushion the impact of losing revenue sharing. Further cutbacks in state and local spending would have a negative impact on employment as well as reducing public vital services.

The concept of federal countercyclical anti-recession assistance to state and local government has much to commend it. Currently state and local governments tend to expand employment and spending when national economic policy calls for the reverse, and to cut back during recession.

For this reason, I support the much needed Intergovernmental Anti-recession Act of 1975, which would provide the needed resources to state and local government to reverse this cycle in times of economic trouble. This assistance should not to be encumbered by categorical restrictions and should be provided in the spirit of general revenue sharing.

If we are to tie entitlements in the countercyclical program to unemployment rates, as Comprehensive Employment and Training Act funds are now, the federal government must cooperate with the states in improving the statistical validity of these unemployment estimates.

There have been some areas where communication and cooperation between the federal government and state and local governments has improved substantially. The procedures for consultation with state and local government in the Congressional Budget Reform Act, the recent willingness of the Executive Branch to consult with state and local officials and the requirement of inflation impact statements of federal actions on state and local government budgets are all moves in the right direction. Further improvement could be made if state and local impacts were more thoroughly considered in the development of the federal budget and in economic forecasting.

In conclusion, I want to stress that I am not here to suggest that the role of the state and local governments is confined to standing in line waiting for federal handouts. I do believe that federal funds can appropriately be made available in the areas I have mentioned.

At the same time, state and local governments have a real responsibility—whether revenues are increasing or decreasing. That responsibility is to start resisting the pressures to spend dollars on every problem that comes over the horizon—and to install better management techniques to help control burgeoning bureaucracies. This means, for example, elimination of low-priority programs, fighting the spread of middle management, installation of zero base budgeting and management by objective systems, controlling payrolls, and eliminating marginal research and planning activities.

Thank you.

Chairman HUMPHREY. Mayor Young, my colleague, Senator Percy, has to go to another important meeting and he wanted to take a few minutes to ask Governor Walker a question.

Mayor YOUNG. Fine.

Chairman HUMPHREY. Senator Percy.

Senator PERCY. Thank you very much, Mr. Chairman, I appreciate it.

Governor Walker, Illinois received $311 million in Federal revenue sharing funds in fiscal 1975?

Governor WALKER. $311 million, yes, sir.

Senator PERCY. And in fiscal 1976 you will receive $322 million. About a third of that, a little over $100 million goes to the State itself; two-thirds to local communities.

How important, in your judgment, is it that we continue to keep Federal revenue sharing as a major part of our Federal budget, how much help and assistance is it to the State and to local communities?

Governor WALKER. I think it is absolutely vital that it be continued, Senator. In Illinois, we funnel all of our State revenue-sharing proceeds from the Federal Government into elementary and secondary education. Without that, we would have problems funding these educational areas to the extent needed and without Federal revenue sharing local property taxes would inevitably go up.

So, not only from the standpoint of protecting the taxpayer, but also in terms of providing vital services to people who need them, Federal revenue sharing on a planned basis—that we know we can count on year after year—is vital to Illinois.

Senator PERCY. My last question deals with the headlines in newspapers in Illinois the last week or so, all over the State, about your demand that we slash the State budget by 6 percent. Now, you indicated that was due to the recession. The figures were put in, as I understand it, in March, and this is June. What has happened to the economy so precipitously in that 90-day period that would cause a major cut of $300 million in the State budget, and this anguish that you expressed to the State legislature? We would be quite interested whether the economy itself moved down that rapidly to attack your revenues that much in the State, and is it happening in other States just as well.

Governor WALKER. I think it is, Senator, and that is based on my conversations with other Governors. But, to be precise about what happened, some of the 20–20 hindsighters now say we should have seen that coming 3 or 4 months ago.

As I noted in my remarks, we put our budget to bed in late February. At that time I suggest neither I, nor any responsible economist I knew of was aware of how deep the recession was going to go. We tracked month by month our State revenues against the estimate on which our budget is predicted, and in January, in February, and in March there was no significant fall off in State revenues below the estimates on which the budget was built. In April there was a small shortfall, and in May we got clobbered.

Now, if I had gone to the legislature—and with your experience you know this—if I had gone to the legislature back in March or April and said, "Hey, it looks like we are going to have some problems here, we've got to cut," I think you know the kind of reception I would have gotten, making those reductions. It required dramatic evidence. And the dramatic evidence came in May.

And as soon as I saw that very substantial decline below estimates I knew we had to act, and I did.

Senator PERCY. Thank you very much, Governor Walker. Thank you, Mr. Chairman.

Chairman HUMPHREY. Thank you.

Mayor, we welcome you here; my most recent visit to Detroit was for the Walter Luther King Library dedication at Wayne State University, and I am pleased to see you once again.

We look forward to your testimony on bahalf of the National League of Cities and the U.S. Conference of Mayors.

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

Mayor YOUNG. Mr. Chairman and Members of Congress, as you indicated, I came here not only as the mayor of my own city of Detroit, but on behalf of the U.S. Conference of Mayors and the National League of Cities.

Once more I appear before a congressional committee hoping to find help—or even some sign of understanding—for the problems we face in Detorit. These trips seem to run together, in a way. Each has been characterized by an urgent plea for help, some concerned head-nodding, and nothing more.

Last winter, when I appeared before a committee of the Congress, the city of Detroit had already eliminated many hundreds of jobs through a hiring freeze policy. In January, just after another meeting with concerned Congressmen, we laid off 1,500 city employees. Seven hundred more were let go last week. I might indicate that in Detroit this problem is much more intense than anywhere in the Nation. We have, through attrition, through a hiring freeze, and now mainly through layoffs, reduced the work force in our city by some 20 percent. We are down from 25,000 to approximately 20,000 city employees. To underline the desperation, for the first time since the great depression we have been forced to lay off police officers, firemen, and nurses; that is going on now in our city.

The last two times I testified before congressional committees the unemployment rate in Detroit was 22.1 and 23.6 percent. That means, quite simply, that very close to one out of every four working men and women in Detroit were jobless. One out of four.

There seem to be many Americans, and even Members of Congress, who do not understand how bitter people become after they spend months looking for jobs—without success. When spring came in Detroit this year, 130,000 men and women were out of work. That's a lot of bitterness.

The Congress and the Nation and the White House began to show deep concern about unemployment when the national rate reached about 8 percent. Detroit's unemployment rate has been closer to three times that figure for much of 1975. And the actions of the Federal Government, to be quite frank, have been to provide an 8-percent solution to a 25-percent problem.

No responsible Army medic would take his last 50 drops of medicine and divide them 1 each among 48 soldiers with head colds, and 2 on the edge of delirium and death from malaria. Yet, that seems to be the philosophy of the Congress today, as it approaches the problems of America's big cities.

What kind of a system have we designed that can ignore, for months and even years, a public need of such size and duration?

When a tornado flattened houses and businesses in the tiny southern Ohio community of Xenia, the President of the United States and many Members of Congress and a whole Federal Government moved quickly with massive steps to ease the sufferings and speed the recovery.

But, when Hurricane HUD ripped through Detroit, destroying many times as many homes, blighting whole neighborhoods and leaving burned-out buildings, drug dens, and useless wreckage in its wake, the same Government all but turned its eyes away.

More than one hundred persons are in jail over that scandal. More than 12,000 homes are boarded up in Detroit today, and thousands and thousands of vacant lots offer mute testimony to the destructive power of the hurricane called HUD. Nearly one-third of all the HUD repossessions in the United States are located in the city of Detroit, but few cry in anguish over the unnatural disaster that has deeply scarred my city.

Detroit has been trying to deal responsibly with shrinking revenues, rising costs, and a charter mandate for a balanced budget for more than a year.

First, we instituted a hiring freeze. The, we laid off needed city workers in the sanitation department. We shut down the city's recreation centers. We laid off rat exterminators and dogcatchers. We shut the art museum—it is closed today, gentlemen—and laid off public health nurses and we closed the city's immunization clinics.

It is not easy and not wise to cut back essential city services during hard times, when many of the people in our city are most in need of that service. But, there is no choice in Detroit, nor in many other cities across the Nation.

We have been able to restore many services because of the Federal funds made available through the Comprehensive Employment Training Act. But it is neither fair, nor a reflection of the will of Congress, I believe, to use CETA funds for the exclusive purpose of guaranteeing city workers job security.

Men and women who have not been able to find work for more than a year grow justifiably angry,when Federal unemployment funds are used to hire city workers who have been out of a job only 30 days. Our available CETA funds, in short, are exhausted. Thus, the 700 workers laid off last week, and the more than 200 firemen yet to be dismissed, are gone. In Detroit there is no alternative but to cut back on services.

We have tried all other methods. Our people are taxed at the maximum 2 percent of income permitted by the State legislature. Our property taxes are assessed at the maximum allowable. I would indicate that the city of Detroit pays the equivalent of some 85 mills of taxation, far and away the highest tax rate of any municipal unit in the State of Michigan.

Every member of my staff, all department heads and deputies, and every mayoral appointee in the city—including myself—has agreed to forego the pay increases and fringe benefit improvements scheduled to go into effect on July 1. The city of Detroit, known everywhere as the motor capital of the world will purchase no new cars this year for the first time in a long, long time.

New programs in the police department have been delayed indefinitely; and we have had to accept severe cutbacks to avoid the layoff of 550 police officers. Development plans for the central business district have been shelved. It is no longer within the power of the city of Detroit to do more, let alone begin to deal with the despair of unemployment that has crippled our city.

Detroit struggles, like every other city, with a serious and growing crime problem. We very much need a more professional, more racially balanced, and more community-minded police department. LEAA has provided all the guns and helicopters and rifles, and cars and equipment that it can. But Detroit needs people, men and women with professional skills and a community conscience to begin to turn the crime rate around.

In an almost whimsical twist, CETA funds provide the city with low-paid workers in some abundance—but no moneys for bricks and mortar for building plans and supervisors, and projects that could make meaningful changes in the city.

We in Detroit are doing everything we can to deal with our own problems, but it is not enough. We can do no more alone. We need help. We need a hand—but we are not asking here for a handout. I think it is self-evident that we are also helping ourselves.

Last year we began work on a plan to move Detroit forward. It drew ideas and then support from the business community, from labor leaders, from Republicans, Democrats, bankers, community people, and pastors. The plan, which we presented to President Ford several months ago, focuses on jobs in both the public and private sectors.

Moving Detroit forward means the conversion of 12,000 boarded-up buildings into sound homes for Detroiters. It means tearing down old industrial buildings to prepare new development sites. It means new towns in town, and sweeping changes in the decaying commercial corridors of our city. It means a people mover system for downtown, malls in our central business district, and a mass transit system.

We are not talking about leaf-raking, and we don't mean leaning on shovels. The plan to move Detroit forward is a comprehensive effort revitalize our city's economy, replace welfare checks with pay checks, increase tax rolls and get things moving again. I believe it is a plan that could be a guide for other troubled cities.

The business community has already made an extraordinary gesture of good faith and confidence in our city. One of the largest privately financed developments in the world, the Renaissance Center, costing in excess of $600 million, is now rising on the Detroit waterfront, symbolic of a new determination to make our town work. As a matter of fact, I am leaving here early today in order to get back to Detroit to open the top of the first office building, a 39-story office building, that is surrounding a 70–story hotel. Detroit clearly has the potential and it has the people, to make the kind of inspired leap toward renewal already made by such cities as Toronto.

To do what must be done we need no special favors, no under-the-table game, no log rolling, no exercise of power by our senior Members of the Congress, and not even a bill by a Michigan resident.

Detroit, quite simply, has the greatest need. No city approaches our unemployment problem. Few deal with a crime problem as great. Mass transit is nonexistent in Detroit, while billions are spent in smaller towns like Buffalo, Cincinnati, and even Washington, D.C. And finally, no other city in America has been as ravaged by either flood, fire, or tornado as Detroit has been by HUD.

The tax base will continue to decline without help. Our efforts to rebuild on our own are crippled by prohibitive interest rates. In order to rebuild our old city hospitals, we first had to win a State legislative action that changed limits on interest rates, and then sold bonds that carry exorbitant rates. You might be interested in knowing, gentlemen, that just as of yesterday we accepted a bond offer on Wall Street that costs us 9.8 percent interest.

Chairman HUMPHREY. On tax-exempt securities?

Mayor YOUNG. On tax-exempt securities.

Chairman HUMPHREY. That's robbery.

Mayor YOUNG. Rape.

Chairman HUMPHREY. That's outright robbery.

Mayor YOUNG. This underlines a point, Senator, that I made earlier, and which faces every city in America. We had a choice of going forward and building a much needed general hospital, or taking a chance on waiting, and let inflation cancel out whatever benefits we might receive by lower interest; it's a rock-and-a-hard-place.

Chairman HUMPHREY. I know. But that is the most drastic example of what is happening to municipalities that I have ever heard, 9.8 percent——

Mayor YOUNG. 9.8 percent.

Chairman HUMPHREY. On tax-exempt securities. I want to tell you—stealing ought to become legitimate.

Mayor YOUNG. It is legitimate, sir. [Laughter.]

There must be a better way.

Chairman HUMPHREY. Senator Javits.

Senator JAVITS. Mr. Mayor, if you would give us a minute, we have the same terrible problem in New York; we can't even get the money. I think we would be deluding ourselves if we think there is any other way than through governmental intercession because it isn't one of these big banking firms that is shelling out its own money, or some banks putting up capital funds; we are talking about handling people's money. And while the investors can make a profit, the fact is that investors are not buying the securities.

And what is the reason for Federal Government; if it isn't going to pitch in now and give a hand to the cities?

One thing that I have found, and I think Senator Humphrey has had a similar experience, is the fact that we still don't realize that this is an urbanized country, and this realization is at the heart of the problem. Anything you can do would be helpful to stimulate understanding by your Congressmen and Senators that your State is urbanized and no longer a rural county. No cognizance whatever is taken of the fact that New York and Detroit are completely urbanized cities. You can make it on a regional basis, but you can't make it on a city basis, and that's the answer.

Mayor YOUNG. I agree absolutely, Senator.

Chairman HUMPHREY. On this point we are in concurrence, but the problem is, there is no majority of the Senate and majority of the House. We will return to that in just a minute.

Mayor YOUNG. To underline Senator Javits' point, to us, short of governmental intervention, there is no other way. So, we do what we have to do.

An aide to the mayor of Stockholm was in Detroit several weeks ago. He said that Sweden—slightly smaller than Michigan—spent more than $500 million in antiunemployment programs alone last year. The program is sophisticated enough, he said, to target such funds toward specific problem areas within a city.

There are few signs the Congress is preparing to take the kind of precedent-shattering steps adopted to fight economic depression in the 1930's. I believe we will become a nation of Detroits, a nation of New Yorks, and a nation of Newarks if we do not. We must find a better way.

I am a Democrat, as most of you know, I am a national committeeman. I have had the pleasure to be with the chairman of this committee in many campaigns. I am a strong partisan, and I believe in different routes to different solutions than the administration that now sits in the White House. I find since we promoted a Detroit man to President, President Ford, and half-a-dozen Cabinet Officers, we have had repeated signs of interest, cooperation, and hope. Our Transportation Secretary, William Coleman, has personally taken an interest in Detroit's transit ideas; and it seems reasonable to believe that something meaningful will happen after years of waiting.

The new Secretary of Housing and Urban Development, Carla Hills, has indicated Detroit may find a positive response in our request for some $400 million to begin to deal with the wreckage of the HUD program, and to revitalize our commercial and industrial areas.

The President has said he sees a qualitative difference between the problems of New York and Detroit, and that the self-help efforts of our city are deserving of attention. Within the limits of their philosophy, the leaders in this administration are actually doing something that could mean a difference for the people of Detroit.

Yet, the Congress, controlled by members of my own party, by Democrats who have long been supportive of changes in national priorities, is not moving in any meaningful direction I can see.

I think you should know how I feel—how tens of thousands—more than 100,000 out-of-work Detroiters feel—I'm putting it on the line—as far as the big cities of America, Mr. Chairman. We have waited a long time for a change. Our party has talked of a special commitment to the cities, to the urban poor. Our party has sharply criticized the Ford administration for focusing on foreign rather than domestic problems. And Democrats, we are told, really care about people.

Mr. Chairman and Members of Congress, Detroit is in need. Our people are willing and ready to work, but we need a hand. We can renew our city—and all troubled cities—with some imagination and commitment to change. And the Democrats control the Congress. It's time, I believe, to put up, or shut up.

Thank you very much.

Chairman HUMPHREY. Thank you, Mayor Young. You have presented a substantial and strong statement. I am going to see that your testimony, and Governor Walker's statement will be made a part of the Congressional Record. In addition both shall be included in the Joint Economic Committee's News Letter, which goes to every Member of Congress.

You gave us some straight talk, now let me give you some straight talk, too.

Secretary Simon has testified before this committee, and to the Nation, that financing a large deficit and simultaneously providing money to the private market will lead again to rampant inflation. That doesn't help; and it frightens people.

Public opinion polls show that the major issues are inflation, as No. 1, followed by the Federal deficit, and then crime. And strangely enough, employment, which I think is our economic Vietnam, is listed down about fourth or fifth. Congress is aware of these polls.

An employment bill which Senator Javits, myself, and other committee members worked on, was passed by Congress and yet vetoed by the President. The funding of $5.3 billion was not enough, but it would have given us several hundred thousand more public service jobs, and it would have provided for the "bricks and mortar" that you mentioned in your statement. You are absolutely right, the CETA program without funding for bricks and mortar, and equipment, loses much of its impact. But that program was passed by the Congress, and it was vetoed, and we were short 5 votes in the House to override the veto. There are people that are frightened to death about the Federal deficit. They are not worried about what is happening to people, what is happening to people's lives. I grant you that this is a major problem that we have here.

We had a housing bill that Senator Proxmire and I worked on, which would have provided 6-percent interest for the first 4 years of a mortgage, or, a maximum of 7-percent interest for the life of a mortgage; this would have provided approximately 800,000 jobs for construction workers; and 400,000 new housing units within the year. And it would also have given relief on mortgage foreclosures to over 100,000 people who are currently unemployed.

Nine members of this committee sent a letter to the President the day before yesterday, urging him to sign that bill. We are informed that he is going to veto it. I hope and pray that I'm wrong because if he vetoes it, there will be another severe blow to the housing industry in this country, which is already in a massive depression.

And yet, I feel your admonition of this Congress is somewhat justified. There needs to be more action as a result of hearings and studies. It is my judgment that some Members of Congress and the President do not sense the seriousness of the economic plight in this country. Recently I spoke to a group of the independent business people meeting here. The President got all the headlines, telling them that we ought to cut down on Government regulations and the Government was too big; and there were 1,500 delegates, cheering.

I told them frankly about severe economic problems in Detroit, New York City, Phoenix, Arizona and even in my own Twin Cities of Minneapolis and St. Paul. Somebody has to start at the national level, not to be just nice, but to lay it out what we have going on here.

I am glad to hear you say that the administration is giving you some help, but remember that whatever help they are giving you, Congress first appropriated the money. And if the administration is becoming aware of the problem, we have many more areas for them to look at.

We have a good working relationship with Mr. Coleman in transportation. But I have not seen anything from HUD that makes me feel very inspired, to be very frank about it.

Mayor YOUNG. To be very frank with you, Senator, we received reassuring promises.

Chairman HUMPHREY. What were they?

Mayor YOUNG. We received reassuring promises. We are now proceeding to attempt to bring those into reality.

Chairman HUMPHREY. I hope the administration will appreciate the kind remarks that you have made about those assurances and promises. But I must lay it on the line—promises are worth nothing; what counts is that the money goes into the program, and without it, there's no program. That's what the problem is.

We've got Allen Greenspan, we've got Bill Simon, and we've got Arthur Burns coming down here scaring the living daylights out of the Congress half the time. I go to the Democratic Caucuses, and I wonder where I am sometimes. Are we so worried about the Federal deficit?

Obviously, the Federal deficit is a matter of some concern; but the way to get out of it is to work our way out.

I want to thank you again very much for your testimony. As a matter of fact, may I say that is the most powerful testimony on urban life that we have had before this committee.

I have spoken with the distinguished mayor of New York last week, and likewise Senator Javits has been working hard to get some help for New York City. I am in full agreement with what you and Senator Javits have said—these cities of ours are in desperate situations; and they need our help. They are not going to get it with the Government admiring the green grass, or riding calmly along the waves of the ocean.

I noticed an article in the May issue of the American Banker, which says that at least eight cities besides New York are in a cash bind and may experience suspension of their credit ratings. Since that time, things have gotten much worse. The article goes on to point out, "The fiscal plight of local governments, represented by a severe liquidity squeeze, is national in scope and may well require Federal intervention."

In my opening statement, I alluded to the Wall Street Journal of June 19, which I would like to quote: "Big Apple Blight. Other cities suffer pains in bond market from New York—hit by borrowing cost rise. Cleveland tries to fight a guilt by association."

And then it goes on to point out that, "Just recently cities like Cleveland have found to their dismay that jittery investors with an eye on New York's most recent brush with a default on its securities are beginning to avoid bonds and notes of many large cities like a plague."

Going on, Mr. Kennedy, the vice president and manager of municipal bond underwriting for John Ravine & Co. in New York says, "Right now the label 'big city' is a negative one. All the big cities got lumped with New York in the minds of investors and brokers."

The Cleveland experience is also mentioned here.

New York City is an international city; it is a national city; it is a port of entry for the United States. Out of sheer national pride, we ought to do something about that city and every other one affected by the crisis.

We ought to turn some attention to this city out of national pride. We have 14th Street right here in Washington. We had those riots in 1968; the dismay, frustration and bitterness like other cities. And yet three Presidents have said, "We are going to do something about this city." I think Washington, D.C., will be a national disgrace in the Bicentennial year. People will see the Nations Capital's torn-out, blighted areas. Everyone can't travel to the suburbs. Certainly, it's beautiful in the suburbs; it's beautiful on Massachusetts Avenue where the Embassies are; yes, it's beautiful where there's been rehabilitation. But whole blocks of this Nation's Capital are just as those mentioned in "HUD Hurricane."

As I said, we have had three Presidents that have made personal promises that they were going to lead the fight to clean up this city, without action. It's a national disgrace that we permit it to be the way it is. And you are so right about that "HUD Hurricane."

We have a bill here which I helped support, for disaster assistance to farm people who were hit by torrential rains resulting in floods. We had a $5 billion bill, assisting people that had suffered from acts of nature. Unfortunately, we don't have any legislation that helps people that suffer acts of government.

I just want to say I agree with you, Mr. Mayor. I wish to God we had more people who shared our concerns. We will try to spread the gospel.

Mayor YOUNG. Thank you very much, Senator.

Chairman HUMPHREY. Hearing no objection, I will place the two articles I referred to at this point in the hearing record.

[The articles follow:]

[From the American Banker, May 9, 1975]

AT LEAST 8 CITIES BESIDES NEW YORK CITY IN CASH BIND, RUN RISK OF SUSPENSIONS OF CREDIT RATINGS

(By Ben Weberman)

WHITE SULPHUR SPRINGS, W. VA.—At least eight additional cities are approaching the cash-short position of New York that could bring a suspension of their credit ratings, Brenton W. Harries, president, Standard & Poor's Corp., told the public finance session of the Securities Industry Association here Thursday.

The fiscal plight of local governments represented by a severe liquidity squeeze is national in scope and may well require Federal intervention, according to members of this industry who are usually well informed about Washington developments.

While Mr. Harries would neither list the cities which will need to raise capital in the market and may be unable to do so nor estimate the gross amount of external financial support that could be needed, others attending the convention suggested that Detroit and Philadelphia are high on the list, and that the size of aid could run into several billion dollars.

Mr. Harries explained that S&P suspended the New York City credit rating in April because his analysts were informed several weeks earlier that the city would need $2.7 billion by the end of June to cover payment of maturing debt. City officials admitted that even if the city did not pay any bills, including wages, during this period there would still not be enough income to cover total debt service requirements. Thus, it was evident that only new borrowings would be able to carry the city through, if new borrowings could be completed, a highly risky assumption.

If the rating agency maintained its A-rating, he said, it most likely would have been subject to numerous investor suits alleging fraud or negligence in not taking into account the information it possessed about financial strains and the absence of liquidity.

If the agency had taken the other alternative of dropping the rating to BS, meaning speculative quality, it could have touched off a panic flight by investors from these securities, Mr. Harries declared. The repercussions on city debt management of a sharply reduced credit rating would have been much worse than suspension, he explained. Individuals and institutions would most likely have refused to advance funds to New York.

Sources who asked not to be quoted but are usually reliable said that the New York City situation could well call for a shocking solution that would take fiscal management of the government away from the mayor, the controller, and the City Council—with their approval—and give it to the Treasury, the Federal Reserve Board and local commercial banks.

These organizations would have the authority to approve or veto, all financial outlays. Such an arrangement could possibly set the pattern for helping other cities in the need of cash. One banker here said this would be analogous to bank aid to W. T. Grant Co. which permits the bank to oversee the restructuring of the retail store financial and commercial operations.

One plan which has been suggested calls for the Federal Reserve Board under Regulation E to provide temporary credit to the city though purchase of tax warrants. This regulation stipulates, however, that such credit must be short-term in maturity and repayment assured by a special date.

The role of the Treasury would be to back legislation giving it power to raise additional money through an Urban Development Bank-type arrangement. Funds could then be advanced from this bank to needy governments, but under strict terms and subsequent close scrutiny.

Commercial banks would be called upon to play a role by advancing funds because they would have the assurance that credit would be sound, one banker close to the New York City situation pointed out.

Another panel session at the SIA learned that a wide gap exists between underwriters and dealers in municipal obligations and municipal finance officers over the responsibility for completeness and accuracy of financial information presented to investors.

Dealers expressed great disappointment that an amendment to legislation restructuring the securities industry sponsored by Sen. John Tower, R., Texas would relieve issuers—state and local governments—of responsibility for compiling or making public fiscal information when they are raising funds through the sale of general obligations.

Dealers insisted that this amendment if retained in the final legislation now before a conference committee of House and Senate members, would place on themselves the burden of supplying information which they cannot possibly get.

An official of the Municipal Finance Officers Association who favors the Tower amendment, and who was present at the meeting, explained that his group believes such reporting requirements would be very expensive, perhaps impossible, for many communities.

Furthermore, he added, this would place local governments in the position of reporting to the Securities and Exchange Commission as they raise money in the capital market, to which they are firmly opposed because they consider this an invasion of states' rights by the Federal government.

[From the Wall Street Journal, June 19, 1975]

Big-Apple Blight: Other Big Cities Hurt by New York Bond-Sale Woes

(By Philip Revzin, staff reporter, The Wall Street Journal)

SEPARATING SHEEP AND GOATS

Cleveland.—Warren D. Riebe doesn't think of himself as a municipal-bond salesman. He has never sold bonds for a living, and doesn't intend to start now.

Lately, though, he has been spending almost all of his time coming on like a salesman, wheedling and cajoling potential investors and reassuring bond holders that their investments are secure.

Why the new and unfamiliar duties? Mr. Riebe sitting behind his paper-laden desk in City Hall here, sums it up in three words: "New York City."

Mr. Riebe is Cleveland's finance director, and the municipal securities he has been touting so vigorously are bonds and notes issued by the city to finance construction projects or to refinance existing debt.

Normally, such tax-free securities are snapped up by institutions and individuals as soon as they're offered. *Recently, however, cities like Cleveland have found to their dismay that jittery investors, with an eye on New York's most recent brush with* *default on its securities, are beginning to avoid bonds and notes of many large cities like the plague.*

"*People are thinking if New York is in trouble, ergo Boston, Cleveland, Philadelphia and others must be in trouble.*" says Jackson Phillips, senior vice president of Moody's Investors Service, a leading rating service for muncipal securities. "Everybody has their own list of cities they think must be in trouble, even if they really aren't.

PAINTING WITH BROAD BRUSH

Siesel E. Canaday, vice president and manager of muncipal bond underwriting for John Nuveen & Co., New York, adds, "Right now, the label 'big city' is a negative one. All the big cities get lumped in with New York in the minds of investors and brokers." According to Bruce Rockwell, a vice president of First of Michigan Corp. in Detroit. "The paint brush is out. Many big cities have suffered considerably in investor confidence simply by being big cities."

Many cities besides "the Big Apple" do indeed have severe financial problems of their own. Like New York, most major urban centers, faced with shrinking tax bases as people and and industries move out, spend far more for operating purposes than taxes bring in. So city fathers repeatedly dash off to the state capital or to Washington for emergency grants. Frequent disruptions of this sort aren't comforting to potential bonds buyers.

"It's absurd to say that any major city has no financial problems," Vincent C. Campanella, Cleveland's budget director, says. "But the problems are of a completely different magnitude than the problems in New York."

Officials in Cleveland and elsewhere are quick to point to New York's habit of financing large amounts of operating expenses with notes and bonds as the major reason for the city's recent near-default on a bond issue. Also, the officials say, the sheer size of New York's budget, its vast public payroll and expensive services, make comparisons with other cities misleading.

Nonetheless, bond dealers, institutions and individual investors are wary that the problems of New York, may be indicative of those in other cities. Some cities that have gone to the market since New York's crisis surfaced in mid-May have found far fewer bond buyers than normal and have had to pay abnormally high interest rates to peddle their securities at all. These increased costs aren't yet a major problem if they are for small or short-term securities issues. But if rates stay high for a long period, the costs could compound the problems of already strapped municipalities.

"TWO-TIER" MARKET

Of more immediate concern is the seeming acceleration of an already developing "two-tiered" bond market. "Buyers in the entire municipal market have really gone to the top-quality credits," says William Clutterbuck, a vice president of Cleveland Trust Co. "New York's problems spread like a cancer, infecting any other city which has problems," he adds. Bonds that haven't suffered noticeably from New York's woes are those issued by cities such as Houston, which isn't considered a victim of urban blight, and which has a top credit rating.

Another direct, if less tangible, effect of the New York situation has been the diversion of many city officials from their normal duties as they try to bolster their city's image. In Cleveland, men like Mr. Riebe and Mr. Campanella, who normally concentrate on municipal accounting and budgeting, find themselves knee-deep in the unfamiliar waters of public relations.

"We're taking the bull by the horns," Mr. Campanella says resolutely as he ticks off on his desk calendar a series of appointments he has set up in the next few weeks with reporters, bankers, businessmen and anyone else who will listen "It's been pretty hectic," he says.

Finance Director Riebe and other officials were angered by recent newspaper accounts that equated the financial problems of New York and Cleveland. A recent front-page article in a local newspaper headlined "Bond Panic Hits City Budget," wasn't well received at City Hall, either.

Mr. Riebe and Mr. Campanella have turned their attentions to a far-reaching public-relations campaign, aimed at distinguishing Cleveland's financial situation from that of New York. Once this distinction is made, they reason, investors will see that Cleveland isn't in as bad shape as New York and will once more smile favorably on Cleveland's notes and bonds.

So far, this effort has consisted of lengthy talks between city officials and representatives of local and national media, a special presentation by Mr. Campanella

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and others to the city council, a meeting between city officials and local bankers and discussions in New York between a Cleveland delegation and representatives of Moody's regarding the city's credit rating.

Mr. Riebe says all this extra activity, undreamed of before the New York crisis, has forced him to postpone some of his regular budget-supervision duties. Mr. Campanella says he and 10 members of his staff have worked nonstop for several weeks to prepare information for the special presentations.

That the officials have ample reason for concern is shown by the city's most recent experience in the money market, shortly after New York's latest problems began hitting the headlines.

During the last week in May, Cleveland offered $39.4 million of one-year bond-anticipation notes to refinance existing debt. Cleveland received only one bid on each of several large chunks of the note issue, instead of the normal three of four bids, and the interest cost to Cleveland on the issue was 7.95%, just under the maximum 8% allowed by Ohio law.

In more normal times, before the market jitters over New York's plight, the interest rate on the notes might have been around 6½%, Mr. Riebe says. This means, he adds that the direct cost of the higher interest rate was about $450,000 for the one-year issue.

Because of the market conditions, the city withdrew $9.1 million of the notes from the underwriting. The underwriters reoffered the remaining $30.3 million to investors at yields of 7% of 7.5%. Despite the high rate, investors didn't exactly scamper to buy the securities.

In fact, some $14 million of the notes was taken by brokers from the underwriters on a "best-effort basis"—that is, brokers tried to sell the notes to investors but weren't under any obligation to keep the notes if they didn't sell. Brokers normally accept such notes outright, confident that they can retail everything they accept. But eventually, Cleveland's notes did sell out at retail.

Cleveland also felt ramifications from the shaky bond market when Cuyahoga County, which includes Cleveland, decided in late May not to issue $15 million in 20-year bonds that would have retired short-term debt on a parking garage the county is building in downtown Cleveland. Instead, the county will sell short-term notes.

The city, of course, is worried most about the long-term effects if investors become disenchanted with its securities. One local bond dealer says he has "stopped recommending Cleveland notes to my more conservative clients, and I advise anyone who's interested in them to be careful that they can afford to absorb a possible loss. I don't want my clients coming to me in a year asking, 'Why the hell did you recommend Cleveland notes to me?' "

Not all brokers and bankers here are so wary of Cleveland's notes and bonds. "Cleveland is among cities with the lowest debts and the lowest tax rates," says Robert B. Blyth, vice chairman of National City Bank here. "If it hadn't been for New York's problems, Cleveland's short-term debt would have sold without any problem. Cleveland is in a fundamentally sound financial situation, in terms of debt security. The facts on this are plain, but the problem is, how do you make these facts known?"

That's what city officials hope to answer in the next few weeks, before Cleveland returns to the market to sell $33.5 million more in notes in late July. By then, Mr. Campanella hopes, "we'll have clarified our financial picture." He adds, "Even our own councilmen didn't understand some of the ways Cleveland operates differently from New York."

Cleveland officials are working overtime to stress, for example, that Cleveland isn't using proceeds from bond-anticipation notes to finance current operating expenses, as New York has done. Cleveland, and most other cities sell notes and bonds only to finance capital improvements.

Cleveland does get some criticism on other grounds. Though its budget has been balanced for the past three years, about 30% of its revenue comes from federal grants. Critics charge this is too great a dependence on Washington. Critics also point to Cleveland voters' repeated rejections of increased city income-tax levies as cause for concern over future city income. The latest tax-boost rejection, in November, triggered the furlough of 1,120 city workers, among them many policemen and firemen. Federal manpower grants have since permitted the recall of these employes, but that's small comfort to investors concerned about municipal finances.

City officials are far from despairing, however, and some see certain positive side effects from the recent turn of events. "There could be a significant benefit if these problems force cities to look at themselves and really tell it like it is," says

Mr. Clutterbuck of Cleveland Trust. "This has been a real cleansing process," says Mr. Blyth of National City Bank. "It has been helpful in that it has shown municipal governments that they are subject to the discipline of the market, like corporations," he adds.

City finance experts are benefiting from the experience of New York, according to Donald Beatty, executive director of the Municipal Finance Officers Association in Chicago. "Our people are looking very carefully at what New York did in terms of financing current expenditures on a longterm basis. They're going to do everything possible to avoid falling into that trap," he says. As part of this learning process, the association will hold a meeting of finance officials from around the country next fall. This meeting had been proposed for years, Mr. Beatty says, but plans crystalized only after the New York crisis.

By the time they get together, the municipal officials may find that things don't look as dark as they do today. One reason is that those cities that have reassuring stories to tell investors will have had time to do so. Another reason is that market jitters historically have eased a month or two after traumatic events.

Many observers expect bond buyers to return to the market, barring any sudden worsening of New York's problems, although they may be choosier about what they buy. "Everybody is going to be more quality-conscious from here on in," says Ivan Gelfand, an investment officer at Central National Bank in Cleveland. "There will be buyers, but everybody is going to do a lot more investigating before they jump in," he says. Adds Mr. Phillips of Moody's: "The market reacted to the initial identification of every city with New York; on calmer reflection, the good issues will be distinguished from the bad. The sheep are going to get weeded out from the goats."

Chairman HUMPHREY. Senator Javits.

Senator JAVITS. Thank you, Mr. Chairman, I just want to adopt everything you have said about the problems of our cities.

Mr. Mayor, Governor Walker and I had the pleasure of hearing your brilliant speech last night in New York on quite a different subject, "Morality in Constitutional Rights"; it was very edifying and magnificent and in a nonpolitical framework.

Governor WALKER. Thank you, Senator.

Senator JAVITS. Mr. Mayor, one thing that is very important is the actual situation of the credit worthiness of the cities. Now, in your city of Detroit, is there any question that the automobile industry, which is so critical to your city, continues to be one of the premier industries of this country; nothing has happened that is going to decrease the American people's need for automobiles, or the world's need for automobiles, has it?

Mayor YOUNG. I don't think so, Senator. As a matter of fact, though, as important as the automobile industry is to Detroit—that is obvious—I think it's important to America in the sense that one out of every six jobs in America are auto related.

So, when we talk about a crisis in autos, we talk about an American crisis. It is a more intense crisis in Detroit, certainly; but it is also an American crisis.

Senator JAVITS. Would there be a major improvement in your ability to borrow money at reasonable rates if we had a U.S. Government guarantee for your obligations?

Mayor YOUNG. As I indicated earlier, I think that's the only way. I can see no prospect of any improvement in interest rates on Wall Street in the foreseeable future for this problem.

Senator JAVITS. Doesn't that also have the advantage of adding nothing to the Federal budget?

Mayor YOUNG. Right.

Senator JAVITS. And you feel that short- and long-term financing with a Federal Government guarantee would again be practical for Detroit?

Mayor YOUNG. I think so. As a matter of fact, we have from time to time sought to get credit of the State, which is relatively better than that of the city. But the new crunch has reduced the State almost to the level of the city; and there is only the Federal Government left.

Senator JAVITS. Do you feel it would be offensive to the dignity of the people of Detroit if the Federal Government said that certain things about your budget and your operations would have to be changed before Detroit is creditworthy enough, in order that the Federal Government is not going to be stuck with the principal debt?

Mayor YOUNG. I don't think so. As a matter of fact, I think any Federal guidelines along the lines which you discuss have already been met by our city.

We have reduced our work force by 20 percent, which means that we are on an austerity budget. We have not just been talking about laying off, we have been laying off.

Senator JAVITS. Mr. Mayor, do you have any grounds to fear that when the debt that is guaranteed by the Federal Government comes due the city will be careless about meeting that debt on the theory of "Let Uncle Sam pick up the tab"?

Wouldn't the credit worthiness of the city be just as much a hazard if the debt had a guarantee as if it didn't have a gaurantee because it would still be owed to the investors, no matter who advanced the money? Isn't that correct?

Mayor YOUNG. Not only our city, but most all cities consist of sound American people who believe in paying their debts. And I can see no reason for anyone to believe the city would be slack in its efforts to meet its obligation because it was federally guaranteed.

Senator JAVITS. Well, Mr. Mayor, the thing that I don't understand, and which seems to be so shortsighted to me is that, nobody ever worries about what General Motors owes; they always worry about how much GM has, and what they are earning. But the minute you get to a city, a big city, everybody is always worried about what they owe, if the city debt is guaranteed, without the slightest regard for the city's assets.

And these blighted cities which are across the country are what is going to drive both themselves and the country into bankruptcy. A little enetrprise and a little courage will relieve them.

I would like to join Senator Humphrey in the expression of his sense of indignation of the lack of national acumen. I tell you this, Mr. Mayor, there are a lot of people in Detroit. You have two Senators. How many Congressmen do you have in Michigan?

Mayor YOUNG. Nineteen.

Senator JAVITS. How many?

Mayor Young. Nineteen.

Senator JAVITS. You have a lot of cities in Michigan. Now, are you satisfied that your representatives are all down here beating the bushes for what you need?

Mayor YOUNG. Not completely, but I would say that three-quarters of the congressional delegation—and that includes Republicans as well as Democrats—are actively beating the drums.

Senator JAVITS. One of my assistants tells me that Senator Hart is on my guarantee bill.

May I tell you this, Mr. Mayor, there are 36 States—if my figures are correct—36 States with cities of over 250,000 population. Now, if we can't do what needs to be done it's only because we are tripping over our own feet; there is really no other reason for it. I hope that you will use your influence, and that of your people, toward getting things accomplished.

Chairman HUMPHREY. Mr. Mayor, I just asked Senator Proxmire if he would yield for a moment.

I have submitted a bill called the National Domestic Development Bank Act, which would provide loan guarantees under the authority of that structure. It will do for our cities and local governments what the American Government does for the rest of the world.

We have a World Bank in which we have 70 percent of the capital; we have an Inter-American Development Bank; we have the Asian Development Bank; the Central American Development Bank. There is the African Development Bank. We have a foreign assistance program in which we have development loans for communities that don't have as hard a time as you are having right now in Detroit. We make grants; we make technical assistance; we have guaranteed loans for private investors that will go into some of these foreign communities and bring in private investment.

It makes sense that we use the better parts of that experience and apply it to some of our municipalities before they go down the drain.

Let me conclude on this point. I see something happening in our cities, Mr. Mayor, that I don't like; namely, the cities have become the home of the poor, the needy, the unemployed, the elderly, and the ethnic groups, particularly the blacks, Puerto Ricans, and urban Indians. And there is a new kind of racism going on in this country by the neglect of our urban areas, and we'd better recognize it. You can be certain if some other people lived there, they would have shown a little more interest.

I just want to put it on the line; that's Hubert Humphrey's view of the neglect of the urban American.

Mayor YOUNG. I think you are absolutely right.

Senator PROXMIRE. Mayor, you have one of the most difficult jobs in the country, and one of the most challenging and heartbreaking jobs. But I'm puzzled by your statement here, by several aspects of it. You have a very colorful and interesting analogy of the "Hurricane HUD" ripping through Detroit, the 12,000 boarded up homes, and so forth.

And then you end up with the charge that the administration has been sympathetic and helpful, and the Congress doing very little, or nothing. I just don't understand what you are talking about, and I would like you to elaborate your interesting and refreshing position.

What, if anything, has Congress got to do with "Hurricane HUD", wasn't that bad administration on the part of the administration; is there anything that anybody in Congress could possibly have done about that?

Mayor YOUNG. I don't think the Congress can be held responsible for "Hurricane HUD."

Senator PROXMIRE. I'm thinking out loud, not only because it is interesting, but also because this is one hard, clear case where you say you are going to get the money; and I'm going to challenge that, too.

Mayor YOUNG. Well, I hope that your challenge will be unfounded, and if we don't receive the money, I certainly would have to consider it as a valid challenge.

We came to Washington several weeks ago, as I indicated, with a cross-section of our city. Some 25 people, ranging from the heads of each automobile company located in Michigan, the head of Burroughs Corp., two principal labor union presidents of international unions located in Detroit, bankers, businessmen, community people, and church people; a representative cross-section of the city assembled to talk to the President and Congress.

We presented a $2.7 billion program to "Move Detroit Forward." You might say the program was divided into two areas.

Senator PROXMIRE. A $2.7 billion program for Detroit?

Mayor YOUNG. Yes. Now, if that seems like an awful lot of money, Senator, I might just indicate to you that when in the period of the 1930's this Government felt impelled to rescue foundering cities, some $11 billion was spent. When we look at the population of the country today, it is double of what it was in the 1930's; and a dollar is worth about one-tenth of what it was worth at that time.

Senator PROXMIRE. You came in with a request for about $2.5 billion, and in your prepared statement you indicated only $400 million in hard figures.

Mayor YOUNG. I am trying to divide it in two packages. One package consist of our attempt to make available to us moneys that are already available through some programs passed by the Congress and approved by the President. The two major categories there were some $700 million that would go toward the mass transit system in Detroit. We are in the process of moving on that with UMPTA. And another $400 million would deal with the HUD housing problems, and we are moving on that.

There are other increments of money already available, from the LEAA, et cetera. Approximately half of the $2.7 billion that we sought would have had to have resulted from action in Congress.

Now, I have been down here, as I indicated, almost weekly—I'm practically a commuter to Washington—in support of intergovernmental public works, in support of many bills—many positive bills that Congress has presented.

But what I'm saying is what I really don't understand, that a Democratic Congress, interspersed with supposedly liberal Republicans, cannot override the President's veto on matters so essential to the cities.

I am a former State legislator of the Michigan Senate, and that is not confined to Washington. For the first time, I believe, since 1964, we have the same situation you have here in Washington, both houses of our legislature dominated by the Democratic Party, and the Governor is a Republican.

Senator PROXMIRE. Mayor, we don't have a two-thirds margin in the Senate. We have 61 Democratic Senators, there are 38 Republican Senators. So, we would have to get every single Democratic Senator plus five or six Republicans. We might have some fine liberal Republicans, but we also have some conservative Democrats.

I think it would be obvious to anybody who would take the time to look at the Senate and at the House, that it is most unlikely to override most Presidential vetoes. We have tried over and over again throughout the years; I think we overrode something like two of Eisenhower's more than 40 vetoes. This is a very difficult thing to do.

Mayor YOUNG. I understand.

Senator PROXMIRE. Let me get at what the problem is here. We have passed, have signed into law legislation to provide money for the cities. We have the public housing legislation, the money is there, they have it; the President signed it into law. We have 235 money, where people get home ownership. We have 236 money, the money is there, it's passed. Housing for the elderly we enacted into law. The money is there, but the administration refuses, one way or the other, to make it available, to spend it. I don't know what else Congress can do. We have gone to court, we have done everything we know how to do.

Let me take up this $400 million that you are talking about. I think that's a dream. I wish it were reality, but I think it's a dream, and I tell you why. I just checked this, and found that Detroit has something like $34 million of community development money, and they only have that for 1 year, and you are going to have less next year.

The entire discretionary fund available to the Secretary of HUD, Mrs. Hills, to whom you referred specifically here, she had $50 million for the entire country in one fund, and $50 million in another; so that is $100 million for the whole country. Now, Detroit can't get $400 million out of that very small pot.

Carla Hills, Secretary Hills, came before our Housing Subcommittee the other day. She indicated that housing is in this worst recession we have had in 35 years—at this time housing is a basket case—the Federal Government will have assisted housing starts this year at a level only one-third of the annual goals for assisted housing that has been the law since 1968.

Now, we are doing everything we can, and if you will tell us what else we can do, we'll do it.

Mayor YOUNG. I hope that I'm understood here. I represent a beleaguered city. The people of my city can neither understand the President's vetoing something like this much needed legislation, nor the Congress' failure to override the veto.

I don't come here sitting in judgment on anyone. I come here telling you that we have a serious plight, and that neither the executive nor the legislative part of Government, neither branch, is at this time answering our needs.

Senator PROXMIRE. Well, where do you expect to get that $400 million? You say, "Detroit may find a positive response in our request for some $400 million to begin to deal with the wreckage of the HUD program."

Major YOUNG. Well, part of our approach in Detroit has been that the whole HUD program of the last several years has been a disaster, as I have stated. We are dealing here with a policy question on the part of HUD. We approached them early in my administration, over a year ago, and were promised some 2,000 homes, repossessed homes, which were turned over to us, together with a revolving fund, and we could rehabilitate them and turn them over to the people. So, we could do those two things, provide jobs—a minimum number, of course—and housing.

Now, we have been negotiating for years. Our State housing authority has promised 1,000 homes, that's 3,000. We haven't seen them yet. But it's these types of approaches, the guarantees, the HUD guarantees of investment that we need.

For instance, we are now engaged in an attempt to put a massive apartment structure in that would have a massive effect as an economic catalyst on the city, together with the Renaissance center; and that would need HUD support, HUD guarantees. It is a combination of those.

Senator PROXMIRE. Well, maybe, for the record, you and I can have a personal discussion about this. As you know, I am chairman of the Appropriations Committee that appropriates the money for HUD. I have checked with the staff and they don't know any place you can get this kind of money, or anything like it.

Mayor YOUNG. I will leave with you, Senator, a copy of the "Moving Detroit Forward" plan.

Senator PROXMIRE. Very good.

Now, let me ask you this, Governor Walker, I have the greatest admiration for you, and you certainly come in with fine credentials, somebody that is not only interested in the economy as a businessman, but somebody who has a fine record as Governor——

Mayor YOUNG. May I be excused, now?

Senator HUMPHREY. Mr. Mayor, thank you for sharing your time with us, and we appreciate your valued testimony. Good luck, I hope that everything works out for you today.

Mayor YOUNG. Thank you very much.

Senator PROXMIRE. Governor Walker, you have indicated that you would like to see a countercyclical program worked out, so States wouldn't have to aggravate the recession by cutting payrolls, which they have up to now; by laying people off, and increasing unemployment.

What worries me, however, is something that may not worry all Members of Congress, but I know it concerns you, and concerns me very much, and that is the fact we had a very praid increase in Government spending, very rapid. We all think about the increase in Government spending at the Federal level, and it's big; but it is far bigger at the State and local level. Since 1960 there has been an increase of 190 percent in Federal spending; but there has been an increase of 300 percent in State and local spending, from $51.9 billion to $206 billion, an enormous increase.

What would you have in your proposal that would indicate that we would be able to carry this countercyclical action out, without aggravating this trend toward more and more government, and a bigger and bigger burden on the taxpayer, and greater inflation? Maybe, if you can solve that and break through, we can get more support for the countercyclical program.

Governor WALKER. Well, No. 1, Senator, in times of crisis like this, I think a countercyclical program is a good one, as long as it is on a short-term basis.

If you ask me my "druthers", as they say, I would prefer to stimulate the private economy, rather than to pump more money into the public sector, as I have tried to do in Illinois with some success.

I mentioned earlier, Senator, that in the first 2 years of my administration, before the recession came along, while our revenues were increasing, I reduced State employment by over 5,000 jobs. There are 5,000 fewer people on the payroll in Illinois today as a result of that.

Senator PROXMIRE. That is what I meant when I said you have excellent credentials.

Governor WALKER. I would like to see the emphasis placed on the construction side because that is the best way we can put the money into the private sector. And, speaking of large amounts of money, I asked our legislature for $2 billion of bonding authority, so that we could go ahead with short lead-time projects—providing jobs this summer, and this fall. I think it's a bad mistake to try to pump money into long-term projects by the time we get around to building these long-term projects the recession probably will have been behind us, and we will be back into an inflationary period.

As I mentioned in my testimony, my hope is that the new public works program you are now working on, will be forthcoming. This is where Federal action can really help, if the programs go into short lead-time projects.

Senator PROXMIRE. That is very helpful. And, you have two criteria, No. 1, as much of the stimulation as possible should be in the private sector, therefore housing, which is overwhelmingly private, and construction projects which consist mostly of the discipline of the private sector.

Governor WALKER. That's right.

Senator PROXMIRE. And then, No. 2, you feel that the projects should be short term, so that you can put them to work right now. Now, that's the difficulty. You have Arthur Okun, a distinguished former chairman of the Council of Economic Advisers, who told us that the weakness in the public works program is that they get pennies now, and dollars 4 or 5 years from now when you have a different situation, an inflationary problem. We had that from 1962 to 1967, a big public works project started in 1962, but didn't come into full bloom until 1967, when it was inflationary.

Governor WALKER. That is why I urge, Senator, your consideration of public works projects at the Federal level, that you provide the money—and I know you are thinking about this and have been working on it—to the State and local governments directly, so that we then can put it to work on short lead-time projects.

I mentioned, I believe before you came in, Senator, what I think is a good example, and that is what we call specialized live-in centers for the mentally retarded, so that the mentally retarded in small live-in units in communities could be near their friends and families. This is a part of my accelerated building program. We wanted to build those; we have the plans ready. If we can get the necessary funds, we will be building them this summer, and this fall. Those are the kinds of projects that I think we ought to emphasize.

By the way, I don't have the bond problem—for your interest on the committee—that some other State and local governments have. Our bonds are credited AAA on the high side; and on the bond market our bonds are referred to as collector's items. The last time we went to the market, which was a couple of months ago, we only had to pay 5.25 percent; I think it might be a little higher now. That is for general obligation bonds, of course revenue bonds, for those the amount is higher. I found myself interested in Senator Javits' approach about guarantees. I would like to enter one caveat, and I regret that I have not read your bill, Senator.

If the Federal Government gets into the business of guaranteeing revenue bonds, as opposed to general obligation bonds, then I think we could be headed for some troublesome areas because frequently revenue bonds, as you know, are not tied to specific projects. You will get an awful lot of latitude that may be awfully hard to control if you guarantee on the revenue bond side. On the GO side, I think, it makes some sense.

The other caveat I have that my philosophy is—and I know some disagree with me—that I don't believe in bonding for operating expenses. I have the authority, under our constitution, to borrow up to 5 percent of our general revenue funds to meet a deficit. I refuse to do that in our current fiscal crisis because if you go down the road borrowing money to finance with bonds our operational expenses, the sky can be the limit.

Senator JAVITS. Will the Senator yield?

Senator PROXMIRE. Yes.

Senator JAVITS. Governor, I appreciate both those comments. May I reply?

Governor WALKER. I would like to get better educated on your bill.

Senator JAVITS. I will see that you get it. The bill has its own caveat on another score, because it requires a showing that the city is headed toward a balanced budget. And the reason for that is why I asked the mayor the question about imposing the discipline that warrants the guarantee. If you are going to do them any good, you have to help the community to surmount any technical hurdles, or to administer the necessary bitter medicine.

I will look into the revenue aspect of that very carefully, and I am obliged to you very much for your suggestion.

Now, I agree with you on the latter point about ongoing expenses. But what has happened, you see, is when the market goes to pot because the city can't meet the obligations they contracted for current past expenses, the market also goes to pot for capital issues. The people that take the beating are fire stations, hospitals, schools, and so forth.

Governor WALKER. That is very accurate, Senator. And by the way, as I mentioned earlier, one of the reasons why Chicago, for example, does not have some of the problems that New York City has is because in Illinois we pay at the State level all of the welfare expenses of the city of Chicago. As you know, New York City alone is burdened with that cost. We also pay, at the State level, over 40 percent of the elementary and secondary educational costs for the city of Chicago. And as I mentioned, right now, we are putting about $140 million a year of State funds into public transportation in the Chicago metropolitan area.

So, we have gone a long, long ways to help the major metropolitan areas in our State.

Senator JAVITS. I think there is a big hassle about the percentage New York City should get. There is a big slice of the State budget for the city.

But, I am intruding on Senator Proxmire.

Senator PROXMIRE. No, my time is up.

Senator JAVITS. What bothers me is whether you can lick this thing without the help of superior levels of government. New York City has 8 million people, with better than 1 out of 8 on welfare. Even after you include all the malingering and the goldbricking that you want, the burden is still backbreaking. The New York region has somewhere between 14 and 16 million people and the region within the State has 12 million; most of those 12 million people are working and making a living out of either New York, or work in New York and live in suburban communities. That is the big issue.

And then there is the national responsibility for the migration of people. Where did New York get this population? It got it from other States. Is that a New York City responsibility? It is if they are wage earners, but it shouldn't be until the population becomes wage earners, which is a 10- to 20-year term.

Governor WALKER. Well, Senator, I would agree.

Chairman HUMPHREY. Just a couple of quick questions, and we will let you go, Governor. I want to thank you very much for your extraordinarily helpful testimony.

You mentioned the problem you have on anticipated revenues; changes that came while you prepared your budget. Might I ask what you think will be the condition of budget projections for the forthcoming fiscal year; do you think you will have difficulties beyond those you presently anticipate?

Governor WALKER. I am projecting a deficit of $250 million, and that is what led me to ask our legislature to make a 6-percent cut. So far, they have essentially refused to make the necessary cuts.

They are even taking the very unusual step—which might interest you in view of the national situation—of taking 6 percent of the general revenue fund and putting it in a special reserve, and giving to me—and this will surprise you—the power of impoundment.

I think if I had gone to my legislature and asked for the power of impoundment, their shouts of indignation could have been heard in Washington. But they are now offering the impoundment power because they don't want to take the responsibility of cutting spending in areas like education. So, they want to put the cat on my back. I am perfectly willing to have the cat on my back because in one way or another, I will make sure that our State ends up with a balanced budget and does not have to have a tax increase. That is what I am fighting for; that is the dimension of my problem.

Chairman HUMPHREY. Now, just so this is clear; the shortfall comes even after you made very substantial personnel reductions, and a good deal of tightening up on budget controls. That means that your projected deficit for the balance of fiscal 1975 and for fiscal 1976 of $140 million, is due to essentially the slowdown of the economy.

Governor WALKER. There is one other factor that I must mention. Last fall I vetoed over $100 million of spending that I thought unnecessary—too big a salary increase for State employees, for example. The legislature overrode my vetoes and we spent that extra $100 million. If that money had not been spent, then our fiscal crisis wouldn't be anywhere near what it is today.

Chairman HUMPHREY. But your original budget projections had to be readjusted due to what you discovered later in terms of the national economic picture, the drop in GNP, and the rise in unemployment.

Governor WALKER. No question about it. The major factor that placed us in this crisis position is the revenue shortfall of $140 million.

Chairman HUMPHREY. Do you feel it is a good idea to have included in the second title of the "Revenue Sharing Act" the counter-cyclical grant program on which Senator Muskie and I have been working.

Governor WALKER. I hope that the countercyclical program would not be taken out of the general revenue sharing.

Chairman HUMPHREY. No, it is not to be taken out. I feel that the general revenue sharing serves a very useful purpose, and I want to commend you, sir, for using it for education. Some have not been quite as wise, in their judgment as to the use of revenue sharing. I think it is an exceedingly helpful program.

Governor WALKER. I hope you would proceed in your efforts also, Senator, to add to the countercyclical the new public works program.

Chairman HUMPHREY. Yes, the "Accelerated Building Program."

Governor WALKER. The accelerated public works program.

Chairman HUMPHREY. I agree with what you said here, as to how the program ought to be financed. We must bypass the Federal delay, and get it out to the localities and the States.

Governor WALKER. With the insistence that the program emphasis be on short leadtime projects. And that can be done, I'm sure.

Chairman HUMPHREY. Very good. The staff should make a note of that because we undoubtedly will have new legislation pertinent to it and I would like to have the appropriate amendment, to make sure that we follow the Governor's advice.

Senator JAVITS. Senator Humphrey, would you yield?

Chairman HUMPHREY. Yes.

Senator JAVITS. We did have exactly that provision in one of the titles of the "Public Service Employment bill." Governor, would you want to take a look at what we did there? We funded it with $125 million. Take a look at what we did there, and give us your critical comments whether it does, or does not meet the criteria that you established.

Governor WALKER. I certainly will, Senator. One other point that I would like to see included in this capital construction area—I know it's very hard to draft the language to do it—I would like to see the program confined to the kinds of building projects that help people. I don't think we need more office buildings. I do think we need projects like schools, or smaller institutions for our prisoners, or for our mental health patients. Those are the kinds of projects that we ought to encourage. And those are the kinds of projects—small and community-based—that you can get started on quickly.

But if you let the State and local governments use that money for towering office buildings, it's going to be years before you get them built; and also, you are not helping people in the way I think we should.

Chairman HUMPHREY. Thank you, Governor, very much.

Now, finally, you mentioned Government regulations that are preventing you from taking certain actions needed in economic emergencies to meet human needs that emergencies created.

I have noted that, for example, you mentioned there was a 7-year delay on highway programs. Could you give us some guidance as to which governmental efforts deal with economic programs?

Governor WALKER. One of the areas is with respect to environmental impact statements. For example, as a result of the very tight requirements in an environmental impact order imposed by the Federal

Government, we had to relocate a major highway in southern Illinois simply to avoid disrupting a nest of wood ducks in one case, and a Girl Scout camp in another case. For much less money than it cost us to relocate the highway, we could have moved the Girl Scout camp and the wood ducks.

But the Federal Government required that we relocate the highway. And I have seen it happen repeatedly, even in my brief tenure in office. This Congress writes good law, and offers lots of flexibility. And then it goes over there into the bureaucracy, and some bureaucrat sits there and interprets those laws in the most restrictive way, and writes pages of regulations—sometimes just to justify their own jobs, if you will forgive me. And then our hands are tied, and you say to us—quite appropriately—"Well, why aren't you moving ahead with those projects, we passed the law". True enough, you did pass the law, but the bureaucrats are frustrating you, and they are frustrating us.

Chairman HUMPHREY. Well, I am glad that the Budget Reform Act has a better working relationship with State and local governments. This act was turned out under the excellent leadership of Senator Muskie and Senator Ribicoff along with other committee members. Senator Javits and myself were very active in that program.

I have often felt myself, that the Federal budget as prepared, was unrelated to what the requests originally were, and to the needs of the State and local governments.

And now, as you know, with the Budget Reform Act, we do have at least some ongoing communication between State and local governments, and Congress.

Governor WALKER. If I can make just one last point, Senator. A couple of weeks ago, I had the pleasure of meeting with the President on the highway matter, and the railroad relocation matter. The governors who participated, raised the problem of redtape and regulations with him. And he was shocked by it. I can't help but wonder if it wouldn't be helpful if the appropriate committees of Congress were to call in some of the lower level people. They are the ones who are really causing the problem, and ask them to explain why in the world they require us to go through all of these procedures.

I think it is the middle level of government, the middle level of the bureaucracy that frustrates the desire not only of Congress, but also the chief executive. But if you could find a way to control the middle level of the bureaucracy, to tell them face to face what they are doing wrong, it would have a very good effect.

Chairman HUMPHREY. That is one of the weaknesses, Governor, in the Congress, the failure to have legislative oversight. I do not think we ought to pass a single major piece of legislation unless we constantly monitor the administration. We are very close to our people—most of us travel home to our constituencies frequently, and we hear from our people. I know the difference between being behind the walls of the executive branch in the Federal Government and being here in Congress, where you must be responsive. The constituents can put a body block on you walking right down the halls here, and get your attention.

But when you are a Vice President, or President, or even a cabinet officer, the public is kept away from you. Therefore, if the Congress would have every one of its major committees well staffed, we could have an oversight committee, or a subcommittee, to watch on a regular basis how these laws are being administered. It would be aware of what the rules and regulations are; how the rules and regulations are being applied; what problems, if any, these rules and regulations are bringing about. This would be a much better system.

What actually happens is that we pass the laws; the executive branch, as it must under the law, implements the rules and regulations. We wait for a newspaper reporter to give us an exposé or an irate citizen, or a mayor, or a Governor to come in and tell us how things really are. And what we have then is a constant encroachment of the rules and regulations of Government upon the intent and the spirit of the law.

It is as much our fault as anybody's, and this is something that a few of us around hope will be accomplished. The Congress is afraid of its own shadow when it comes to this oversight function because that takes time and staff.

Governor, I have kept you too long. You have been a very helpful witness; thank you, very much.

Governor WALKER. Thank you, Senator.

Chairman HUMPHREY. I will now call upon Mr. Lennox Moak and Mr. Gedale Horowitz. Mr. Horowitz, I ask you to take the witness stand, along with Mr. Moak; I believe we will bring both of you forward at the same time.

Mr. Horowitz, you are a partner of Solomon Brothers, I understand, and you can give us a good deal of information on the bond market and the financing of our Government issues. We are interested primarily today, as you know, in the State and local governments.

STATEMENT OF GEDALE HOROWITZ, PARTNER, SOLOMON BROS.

Mr. HOROWITZ. Senator, I thank you for the opportunity to be here. I do wish to say in the beginning that I am appearing solely as an individual, and the views which I represent are clearly my own, and not anyone else's.

Chairman HUMPHREY. Do I understand you have a prepared statement?

Mr. HOROWITZ. Well, a very small one. I can dispense with it.

Chairman HUMPHREY. No, no; that's fine. I just wanted to be sure that we had copies of it.

Mr. HOROWITZ. I have a very brief outline.

Chairman HUMPHREY. That's all right; you go ahead as you planned.

Mr. HOROWITZ. Thank you very much.

As I say, my opinions are clearly my own because I am also in another capacity a member of the governing council of the public finance area of the Securities Industry Association, and I wouldn't want anybody to feel the opinions that I express are the opinions or the policies of the industry.

Chairman HUMPHREY. We understand.

Mr. HOROWITZ. Thank you very much, sir.

We are dealing with a real complex matter, I want to restate that, and the U.S. municipal security market is more complex than any other security market in the world.

By the end of 1974, for example, there were 78,268 separate issues of municipal securities; there were only 32,465, of corporate securities; and 1,381,000 separate municipal issues outstanding. There are only 64,486 corporate issues outstanding.

In recent years the municipal market has grown rapidly, the total volume has grown from $36 billion in 1970, including $18 million long-term and $18 million in short-term loans, to $54 billion in 1974, which is $24 billion in long-term and $30 billion in short-term notes, a compound annual growth of 10 percent.

And I might say, in spite of what we heard about interest rates and everything else, all these issues have been handled through the tax-exempt market.

Our function in the tax-exempt market is strictly as a conduit. We do not invest in securities; we are underwriters. And I think you understand that is the same in stock issues, corporate issues, or anything else like that. We purchase issues at risk, and help to resell them to investors. And I first want to discuss the type of investor we have in that market.

There are three main types of municipal buyers, one being the commercial bank, who in some years have purchased as much as 75 percent of all municipals sold. The second is the casualty insurance companies——

Senator JAVITS. I didn't hear the sound.

Chairman HUMPHREY. If you could speak into the microphone.

Mr. HOROWITZ. I'm sorry.

Senator JAVITS. What was the second?

Mr. HOROWITZ. The casualty insurance companies, because of their particular tax bracket. And third, which is much more important, is the individual.

For instance, estimates on last year's financing shows that individuals bought at least 50 percent, and maybe 70 percent of all municipal bonds that were sold.

Now, I would just like to say parenthetically that individuals don't necessarily buy them direct, but through trust funds, and an emerging factor, the municipal bond fund.

We have been faced, in this market—and that is another reason for the rising interest rate as well as credit problems—with a diminution of commercial bank interest in the purchase of municipal bonds for a number of reasons, but the three main reasons are—and this is what the investors have told me:

1. The tax write-off through their leasing operation;
2. Strong tax credits through their foreign operations; and
3. There has been a considerable revaluation of loan loss reserves in commercial banks this year; and of course loan loss reserves diminish their need for tax exemptions.

The casualty companies are the second buyer. You can probably take a graph that shows this buying; and we are in a situation now where there are some casualty companies which are interested, but there are just as many who are not interested.

So, the individual has become a very important buyer.

Now, with the increase in yield, the life insurance companies and savings banks, and savings and loan institutions have become participants in the market, but I will say that when the yield falls, they will again disappear.

I want to touch on just a couple of points with respect to factors which have influenced our market, legislative factors. We don't just finance schools, and streets, and sewers, and the like. The market is a vast market, and there are a lot of things financed which you might not consider municipal financing.

Now, for instance, housing is a municipal function. But when you get a private developer involved—then there is a question if that is a municipal function. Similarly, Congress has said to us, it is perfectly all right for us to market bonds for pollution control, sold through municipalities, tax exempt; hospitals are financed, and there are a number of these types of things, all of which put a demand on the same amount of funds that are available for financing of all municipals.

There have been a number of suggestions. I heard the Senators talk about Government-guaranteed municipal bonds—and I would rather wait and give my opinion when it is discussed—and there has also been the idea of the so-called taxable bond option, the subsidy on the municipal bonds. It is an idea, some people say, whose time has come. The arguments are that it would give the municipalities an option on whether to use the taxable market, or the tax-exempt market.

But the one thing I caution on, on this option. The municipalities with credit problems are not going to be able to sell taxable bonds if they cannot sell in the tax-exempt market.

I have to say that in all 20 years of my business life in the municipal market it has been, and I think will remain, a viable market. I think the tax exempt privilege should remain with the States. Remember also that we are in a time where some people think there is going to be a considerable shortage of capital. If you move the tax-exempt bonds to a taxable bond market, you are going to have to compete in the same capital markets with bonds of corporations and bonds of the U.S. Government. I just give you that as an opinion that I think is something to consider.

Senator JAVITS. I don't want to keep Mr. Moak waiting, but I want to ask you just two questions.

Mr. HOROWITZ. Yes, sir.

Senator JAVITS. One, do you see taking the existing situation, a shortage of capital funds for the municipal market?

Mr. HOROWITZ. No, sir.

Senator JAVITS. Even when you add to it the increasing issues by the U.S. Government?

Mr. HOROWITZ. I believe they do not compete. Let me just say, sir, up to May of this year, we moved $11.2 billion dollars' worth of municipal bonds, that is more than $2 million a month. This, in face of declining interest of commercial banks, and the like.

There is one factor that I should say something about, however, that is, because of the sizable amount of issues, you pay a little more. In other words, the interest rate goes up.

Senator JAVITS. Now, the second question, of the various Federal schemes you have heard to help the cities, which do you think would be more congenial to the investor, the guarantee scheme, or a countercyclical payment? Are there any others?

Mr. HOROWITZ. As an investor I love to have guaranteed bonds. But I wonder, and I can't talk for the municipalities; if you go to a system where all these bonds are guaranteed by the Government, I wonder what these States and municipalities will give up, and are they willing to do so. Again, if you are going to sell a guaranteed Government bond, you are going to be competing with the U.S. Government, and with corporations, also.

I think—and maybe I'm old-fashioned—but I think there is a real separation between the States and the Federal Government.

Senator JAVITS. So, you would prefer to have countercyclical payment.

Mr. HOROWITZ. Yes.

Senator JAVITS. Thank you very much.

Chairman HUMPHREY. Let me ask this question. In light of the related experiences of New York City, which we heard this morning, which of our other cities are suffering pains in the bond market.

Is it possible that many purchasers of municipal securities will be so conservative after the New York City problem that some lower grade issues will actually receive no acceptable bids; or possibly, no bids at all?

Mr. HOROWITZ. I don't believe that no bids will be received. One thing about investors, they are very sophisticated.

Chairman HUMPHREY. Sophisticated?

Mr. HOROWITZ. Sophisticated. We are not in the business where things are quoted on the big board. People who buy municipal bonds do some homework. And I think we have enough investors who are going to say, "I would rather buy a bond with a rating where I have a chance to go to A, or AA, or AAA, as opposed to buying AAA, and then going down in rating.

Of course you are going to pay the price. We have a little trouble with the interest rate in selling these bonds.

On the other question I might say to the Senator from New York State, Senator Javits, that in New York State that is a real problem, he amount of financing done makes some of the rates seem onerous, but that is what the public is telling us. Just to give you an idea, we are involved now in financing for the particular area in the State University. A lot of the tuition comes from the State—loans in the form of scholarships. And I will be honest with you, we have some difficulty selling the bonds at 9 percent. So, there is a problem in areas where you have too much.

Chairman HUMPHREY. Do you have any other questions?

Senator JAVITS. No.

Chairman HUMPHREY. I want to continue on this question. You mentioned the rate of sales, about $2 billion a month so far, and now there is a Big Mac in your New York vernacular. You go to the market for $3 billion worth of securities in the next 3 months, with a rate of about $1 billion a month. Is it possible that other issues will be crowded out and will have to pay higher interest costs?

Mr. HOROWITZ. There is bigger supply in every market. I think that is a fact. I think that Big Mac is a very important issue, and I say this much, we are involved in bringing this issue to the market. Essentially the issue is going to be very fine, but it is going to have an effect on other issues.

Chairman HUMPHREY. Well, I had another question here about Big Mac, which is a new area of interest for me, simply because I am on this committee. But Big Mac will be marketing in New York City's securities for the next 3 months, after which it is assumed that New York will be able to return to the bond market in a normal fashion.

Is this a realistic assessment of the time necessary for the market to do a complete reversal of its attitude towards New York City issues? And what happens in September, or October, and New York City is still unable to market their own securities?

Mr. HOROWITZ. Well, first of all, Big Mac is not—I would hesitate to correct you.

Chairman HUMPHREY. Please do. I don't know very much about it, I'm just asking questions.

Mr. HOROWITZ. Big Mac is not going to sell New York City securities. Big Mac is going to sell securities of the Municipal Assistance Corp., secured by sales tax, and transfer tax revenues.

Chairman HUMPHREY. I understand.

Mr. HOROWITZ. Not New York City securities.

The answer to the second question is, I sincerely hope so. I see the mayor struggling hard with his budget, and I see the city attempting to regain its credibility and standing in the market. We have dealt in New York City securities for as long as I can remember; and I certainly hope we are going to resume it.

Chairman HUMPHREY. Senator Javits, we have Mr. Moak here now. And if you will please wait, Mr. Horowitz, we have some questions we want to put jointly to you and Mr. Moak.

Mr. Moak, I want to thank you for accepting our invitation to come here. I want to include in the record some of the background to Mr. Moak's testimony. Mr. Moak appears as a private citizen who resides at 115 West Mermaid Lane, in Philadelphia, Pa. He is director of finance of the city of Philadelphia, and he has a very prestigious background. We will include all of this in the record, along with an outline of some of his remarks here today. And I understand you are going to speak from that outline?

STATEMENT OF HON. LENNOX L. MOAK, BUDGET DIRECTOR, CITY OF PHILADELPHIA

Mr. MOAK. Yes, Senator.

First, I wish to emphasize the importance of interest as a factor of cost to a local government, or to a State government. You have heard testimony this morning of paying 5 percent interest, and 9.8 percent interest on funds. In order to go from 5 to 7 percent, to 9.8 percent, the Government has to do one of two things; it either has to increase the debt service payment for 30 new bonds by 61 percent; or it has to decrease the amount of money that is going to be borrowed by about 30 percent.

This alternative is one which is sometimes overlooked when you look just at the concept of interest. As a matter of fact, it is rather amazing that on a 30-year 10-percent bond 69 percent of the debt service is for interest.

Chairman HUMPHREY. Would you repeat that, please.

Mr. MOAK. For a 30-year, 10-percent bond, in present value terms, 69 percent of what the Government pays back is for interest, and 31 percent is for the repayment of principal.

Chairman HUMPHREY. No wonder my father told me that the only way to make money was to have it and loan it out on interest.

Mr. MOAK. I have a favorite story in that respect. When Columbus returned from America on March 15, 1493, had he invested $1 at 8 percent in 1493, it would have a value in 1993 of $51 quadrillion. So, your father was on the right track.

Chairman HUMPHREY. How many trillion?

Mr. MOAK. $51 quadrillion.

Chairman HUMPHREY. $51 quadrillion, had he invested a dollar at 8-percent interest in 1493. Oh, what an inventor was the man who invented interest. [Laughter.]

Mr. MOAK. I want to second the proposition that one of the real problems of the investment market today is the withdrawal of the banks from the market. This is the most severe withdrawal that I recall for as much as a full quarter in the years that I have observed the market, which runs back to 1938 and earlier.

This withdrawal has many causes. Mr. Horowitz has touched upon those, and I shall not repeat it. He has also touched upon supply and demand. I submit that we are pressing State and local governments in the performance of their conventional public function much too hard by extending the supply of tax-exempt securities. We have industrial revenue bonds; we have pollution control bonds. Last year, in calendar year 1974, in the State of Pennsylvania, there were $600 million of tax-exempt industrial revenue type securities authorized—not all sold—authorized. There were $1.9 billion of pollution control bonds, tax exempt, authorized, most of which have not yet come to market; $2.5 billion financing authorized.

This is substantially more than all the bonds authorized and/or sold by the Commonwealth of Pennsylvania and all of its subdivisions in that year. We are bloating this market to an extent that it's intolerable in terms of the impact upon State and local government.

Chairman HUMPHREY. Might I interrupt just a moment. Would it be a good idea for the Joint Economic Committee, to make an analysis and survey, nationwide, of the tax-exempt issues or bonds for pollution control, and industrial bonds?

Mr. MOAK. I think it goes far beyond that. I think it goes to the question of community hospitals, and it goes to the question of many others——

Chairman HUMPHREY. The whole spectrum of other than normal municipal issues. I believe we ought to make a note of that, to see what we can do to gather some information because the figures you have given us are staggering. I had not realized for a moment that one Commonwealth, one State could have that large an authorization in such a short period of time.

Mr. MOAK. I would also suggest that you review the policy of the Federal Government itself. In the field of housing authority financing, it seems to me the Congress gets so upset sometimes in tax legislation about tax-exempt bonds, and yet continues to use the tax-exempt gimmick for the financing of public housing projects through the federally guaranteed Federal Housing Authority for tax-exempt bonds.

And in redevelopment, redevelopment notes are tax exempt, backed by Federal guarantees. What the Federal Government gains floods out the tax exempt market.

We have one area in which the State and local governments are themselves responsible, partially because the Federal Government permits in the law advanced refunding of bonds. Under advanced refunding, if I have a bond issue callable for 10 years from today, and the market happens to drop tomorrow, you can refund that bond tomorrow as of 10 years from today, and have two sets of bonds outstanding simultaneously for the same project. As a matter of fact, on occasion we have had more than two sets of bonds outstanding; and I do not think this should be permitted.

Chairman HUMPHREY. How does that work, they send the bill twice?

Mr. MOAK. You sell the new bond issue, and you issue a call and say, as of the call date the old bonds will be retired. You sell the new bonds and put the proceeds of the sale of the new bonds into a trust fund to pay off the bonds 10 years from today, invest them in a Federal Treasury obligation, ordinarily; and you get the benefit of the reinvested rate.

But the impact of this is upon those who do not issue refunding bonds, or do not refinance, adversely affecting the entire market.

The recurring discussions in Congress, and elsewhere, about one way or another of eliminating tax exemptions have obviously resulted in some market presumptions that in some degree tax exemptions will be eliminated or modified. It is my view that tax exemptions should be available without the possibility of Congress tampering with it, insofar as the financing of activities which are carried out by, and facilities which are owned and operated by State and local governments are concerned, in the interest of a clear demarcation of the Federal system.

I would not extend that, however, to the concept of the financing of industrial revenue bonds, and all those types of things. I think that is an open field for discussion, and I would probably be for elimination, or at least for more rigorous control.

I know of one device by which this could be done, and it is of course cumbersome. It could be done through a constitutional amendment which spells this out once and forever, so that we don't continue to get the adverse effects of the conversation about taxation of the tax-exempt bonds, while not getting any of the positive effects of the taxes themselves, if the Congress acts.

Chairman HUMPHREY. The recommendations always come from the Treasury Department. I have often found that these policies must lie dormant in some bureaucrat's mind, and he brings them out to each new Secretary of the Treasury. It doesn't make any difference who is President, what the commitments are on the platform. Every new administration comes up with the same proposal—that we eliminate municipal tax-exempt bonds. That was so when I was mayor of Minneapolis. They were trying to eliminate them—and I was trying to eliminate the Secretary of the Treasury for having such nonsensical ideas.

Mr. MOAK. We have certain problems that address themselves at the moment to core cities that adversely affect their credibility in the market. This will be of interest to the Congress, I believe, and some of them would fall within the parameters of perhaps congressional action.

One of these is the lag of payments by State and Federal governments to local governments. Increasingly, in America, we are using local governments as points for delivery services, the Federal and State governments being the financier. But the financier expects the local governments to perform this service, and then get reimbursed. As a result the local governments do not have the operating funds, and do not have the operating reserves which enable them to do these things; and that is one of the problems that New York has complained of, to a very substantial degree. I have examined New York City's balance sheets, as I have examined the balance sheets of my own city, and I find this a mounting problem. Our receivables have gone up in the last 4 years from $4 million at the end of the year, to an excess of $35 million come June 30th of this year.

This means I must finance that $35 million in the market, or carry surplus to that equivalent. And these are cases where we have rendered the services and have not yet been reimbursed. For example, we are lagging almost a year in the payment for certain services that the city of Philadelphia performed.

Chairman HUMPHREY. These are payments in lieu of taxes.

Mr. MOAK. No, these are payments where the State says to the local government, "Please take care of my prisoners temporarily."

Chairman HUMPHREY. Oh, yes, service.

Mr. MOAK. "I will reimburse you later for taking care of my prisoners," and you wait 6 months, or a year before you are reimbursed.

Chairman HUMPHREY. You ought to charge them 9-percent interest.

Mr. MOAK. You are not allowed to.

Chairman HUMPHREY. That is what the Internal Revenue Service charges you when you are delinquent in your taxes.

Mr. MOAK. I'm thinking about adding a line to our bills to the State and Federal governments—but I'm sure we would be laughed out of court.

Chairman HUMPHREY. You ought to do it. There isn't a charge account in the country that doesn't charge you continuing interest. If you buy from department stores, they start billing you interest immediately. If you own a drug store, as I do, you can't charge your folks interest, they get mad. But if you are a big city, you ought to charge the Federal Government interest. The Federal Government charges everyone else—tit-for-tat.

Mr. MOAK. Among the other problems which very adversely affected our market has been the problem that we have been forced to bleed all reserves we could lay our hands on. In almost all State and local financial affairs there have been various reserves which, if you knew about them, could be used up in times of strong economic pressure. In most cases those reserves have been depleted, and as a result the cities ended up by carrying large amounts of carryover debts, such as New York City has experienced. Most recently tax delinquency has hurt us severely.

The response that I see so far as elimination of the excess supply is concerned, where Congress wants to help our pollution control, is that it is more efficient, and cheaper, to do that directly, as a subsidy, than it is to do it through the device of tax-exempt bonds. Testimony before this committee in 1966 made that very clear to everyone involved.

The Federal Government should move to eliminate the advance refunding of bonds, or at least hold it to 1 to 3 years prior to call date operation.

I think the Federal Government should develop a federally supported taxable bond option. This would be of particular benefit to cities such as New York and Philadelphia, and others which have been mentioned. It is not going to be of tremendous benefit, in my opinion, to the AAA type of issuers, and will not be taken advantage of by them, but we will utilize it to a limited extent.

I think, finally, that there is a need for Federal action which would provide a source for temporary financing for operating budgets in anticipation of revenues, especially by the hard-pressed old-core cities in the Nation.

We do not have easy access to the market; we have a very expensive access to the market. And if we have to continue to use hard-earned dollars to pay these huge interest bills, those are dollars we won't have available for services.

It seems to me that a Federal guarantee system without the benefit of obliging the Federal Government to put up the money initially—or perhaps never being called upon to put it up. But at the same time, it would have the effect of driving down very materially the cost of short term money, which is a very important element of cost—in our case $8 million a year now for short term loans. Debt service on long term debts is $100 million a year. So, here on one item we have one-twelfth as much interest on short term debt as we pay in debt service upon our entire billion dollars of outstanding long term debt.

Chairman HUMPHREY. What mechanism would you suggest?

Mr. MOAK. I would suggest a Federal guarantee of temporary loans in anticipation of revenues by these local governments.

Chairman HUMPHREY. Have you studied Senator Javits' bill?

Mr. MOAK. Sir?

Chairman HUMPHREY. Have you had a chance to study Senator Javits' bill?

Mr. MOAK. I have not had an opportunity to read his bill.

Chairman HUMPHREY. I would suggest that we send it to you. The Senator had to leave here. And, if you will send it back to the Joint Economic Committee we will give you all the instructions, and so forth. Your evaluation and your suggestions will be very much appreciated.

Your expertise would be very helpful; you are a man of considerable experience, and we would welcome it very much.

Mr. MOAK. That concludes my statement, thank you.

Chairman HUMPHREY. Your prepared statement will be placed in the hearing record at this point.

[The prepared statement of Mr. Moak follows:]

PREPARED STATEMENT OF HON. LENNOX L. MOAK[1]

PROBLEMS IN BOND AND NOTE FINANCING FOR STATE AND LOCAL GOVERNMENTS

I. PROBLEMS

A. Erratic commercial bank praticipation in market—loan losses, foreign taxes, and tax preference paper

B. Excess supply of tax-exempt bonds

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[1] Mr. Moak appears as a private citizen who resides at 115 West Mermaid Lane, Philadelphia, Pennsylvania 19118. He is not a professional economist. He is Director of Finance of the City of Philadelphia; Senior Lecturer, Fels Institute of Government, Wharton School of Finance, University of Pennsylvania; and Vice-President, Municipal Finance Officers Association of the United States and Canada. He is widely known for his numerous books and articles in local goverment finance. including his volume on Administration of Local Government Debt (1970) and Concepts and Practices in Local Government Finance (1975). He has acted as consultant to many state and local governments on administration and finance.

1. For financing nongovernmental operations
   a. Industrial revenue bonds
   b. Pollution control bonds
   c. Community hospital bonds
   d. Pressures for other nongovernmental tax-exempt financing—nursing homes, nonpublic schools, etc.
   e. State housing issues
   f. Tax increment bonds for development
2. For governmental operations
   a. Public housing authority bonds and notes
   b. Redevelopment authority notes
   c. Advanced refunding of state and local government obligations

C. Uncertainty as to long-term status of tax exemption

D. Special problems of older core cities and other issuers with low market acceptability
1. Lag in payments by state and federal governments
2. Depletion of reserves
3. Adverse tax calendars
4. Tax delinquency
5. The cloud of New York City experience

II. POTENTIAL RESPONSES

A. Steps to spread impact of shock situations, e.g., write-off of loan losses, handling of foreign tax credits, and reduction of various kinds of tax preference paper.

B. Reduce supply of long-term debt by:
1. Elimination of all or significant portion of sources of excess supply by:
   a. Reduction or elimination of access to tax-exempt market
   b. Provision of more efficient direct tax credits or other assistance now inefficiently provided by tax-exempt bonds
2. Eliminate federally financed tax-exempt securities
3. Hold advanced refundings to 3 years prior to call date

C. Clarify status of intergovernmental taxation by adoption of constitutional amendment which, insofar as state and local government debt is concerned, would verify exemption where proceeds of debt are used solely for governmentally owned and operated programs and facilities

D. Develop a taxable bond option—with no conditions other than that the taxable bond option would be restricted to governmentally owned and operated public facilities

E. Provide for prompt payment of accounts by federal government—both in direct grants and requirement for prompt payments by states in federal-state programs

F. Provide source for temporary financing of operating budgets in anticipation of realization of revenues.

Chairman HUMPHREY. Going back again to the matter of the tax exempt securities, I suppose at this time the only thing of which you could be reasonably certain is that the Congress never listens to these pleas on the part of the Treasury when they attempt to take away the tax exempt status of the securities.

Mr. MOAK. Well, it listens to the Treasury enough to create anxiety in the market, which results in higher interest costs.

Chairman HUMPHREY. I suppose.

Mr. MOAK. Even though there has not been any successful attack in the Congress on it.

Chairman HUMPHREY. They are always discussing tax loopholes for the investors who have been using these bonds, for example, the use of that tax exempt status as a way of financing their much needed municipal operations, and municipal developments.

Mr. MOAK. And it is a necessary element of the Federal system.

Chairman HUMPHREY. Yes.

Mr. HOROWITZ. Sir, to the question of tax exemption, in 1969 we came within 1 day of having interest on municipal bonds included in the minimum income tax. That was included in the House version of a bill, and the Senate killed it.

And, yields on municipal bonds in 1969 got to be 85 and 90 percent of the yield of corporate bonds, taxable bonds.

Chairman HUMPHREY. Because of the fear.

Mr. HOROWITZ. Because of the fear, that's right, that is what Mr. Moak has said. And I would also say that we have heard considerable rumblings that there is a lot of fear that it will be included in allocation of deductions, or income tax again this year.

Chairman HUMPHREY. Well, I can assure you, that will never get through the Senate.

Mr. HOROWITZ. Thank you.

Chairman HUMPHREY. I have not engaged in a filibuster for a long time, but that is the most ridiculous thing I have heard of. I know what it means to cities, and I am opposed to trying to make municipal bonds taxable. I know a lot of wealthy people buy them and they are tax exempt, that is true. But also, that is the one way the city has of being able to finance itself with a reasonable degree of debt charges. It would be a great mistake to change it. That is my prejudiced opinion, and having been the mayor of a city, and having been on the Intergovernmental Relations Commission, being the coauthor of that commission; and having worked with municipal and local government officials most of my life I know of its importance. So, there are some of us here who will take a pretty strong stand about this.

But again, in the uproar of what we call tax loopholes, this is one of those that is considered to be a loophole; which is only another way of saying that sometimes tax loopholes have a very legitimate purpose. Some do have a very legitimate purpose.

The other point you made about insuring that the Federal Government pay its bills—I hope that you will really pursue it. I'm really down on the Federal Government operation, when they are on everybody's back all over the country for not paying their bills. I get letters every day from constitutents where the Federal Government is harassing them. I hope you will harass the Treasury Department. They like to collect, they should be made to pay.

They have been withholding money from people for years and that is the biggest con game in the country. The Federal Treasury withheld millions of dollars of withholding taxes, over and above what they needed to withhold. This was at the expense of the working people of this country. They didn't pay those workers, they gave a refund. If you did that any other place, you would go to jail, and they did this. Just a year or so ago they had $6 billion, or more—I cannot recall the exact amount. It was between $6 and $10 billion withholding, over and above what was necessary, and that was according to the rules of the Treasury Department; and they didn't pay a fine. Why, if you did that any place else, they would have you in prison for 10 years.

Mr. MOAK. Well, that is frequently under the guise of saying that, "You have failed to comply with certain regulations, therefore we withhold the money until you comply."

Well, this is a wonderful bureaucratic game by somebody that doesn't understand and doesn't care how much cost he is imposing as a penalty for failure to carry out what he thinks is the regulation that should be complied with.

Chairman HUMPHREY. Mr. Moak, I hope you are willing to really try to assess the interest charge. I think that ought to be done. I see no reason at all why the Federal Government should be freeloading on municipalities for services they have performed. And, I am going to talk to the Congress of Mayors in Boston, and I'm glad you mentioned this.

Now, the best way to get this thing going is for the mayors to come to these two political party conventions en masse, and start to inform these parties as to what the needs of these municipalities are. They like some political strength, they say, they like to have a little political power.

I think the time is at hand to get some of this information clarified. For example, take these tax-exempt municipals—get them on the political platform. Let's let the candidates for office take a pledge, and swear he is going to recommend tax-exempt municipals.

I have the same feelings that you do about industrial bonds and some to these other bonds; but the normal municipal issues ought to be a tax-exempt issue.

And for services performed the Federal Government ought to pay on time, just like anybody else is required to pay on time. You inform IRS. They go around asking people to pay that interest—you want the Federal Government to pay interest to the city of Philadelphia. I tell you, every week I get letters from people at home, furious because the IRS is assessing them for something that was the IRS's bookkeeping error. Frequently the IRS is behind in its own bookkeeping, and charges the taxpayer an interest charge. They'll charge you to breathe, if they get a chance.

Mr. HOROWITZ. I'm not a municipality, but I do get money withheld by the IRS, but this cry that Mr. Moak is raising, I want to give somebody a little credit, and it won't take very much time.

Mayor Beame raised this question any number of times, going back to the Conference on Inflation. He has spoken to Congress—and I hope, with Mayor Beame that people will listen, not just on the Federal, but also on the State level.

Chairman HUMPHREY. Mayor Beame is a fine man, and I want to say, I sympathize with him for these problems that he inherited, that came along with the recession in New York City.

In recent years there has been a tendency for State and local governments to issue more short term financing, relative to the value of long term bonds. What factors are responsible for the shift to short term financing; and what is the impact on the market of this increasing preference for short term plans.

Mr. Horowitz.

Mr. HOROWITZ. Part of it is people who are not in the financial business becoming market experts and refusing to sell bond issues when they need money. They guess the market, and say interest rates are going down. They then sell bond anticipation notes for a short term; that is what happens a lot times. You sell the issue for 6 months, you could have sold the bond issue for 5 percent; the 6th month comes and the interest rate is 6 percent: And he says, "Oh, I'll roll it over and sell it again", and this kind of thing feeds on itself.

Another thing, guessing the market creates too much short-term paper. And I know the factor Mr. Moak was talking about, notes are sold against receivables. The Federal Government doesn't pay the city of Philadelphia, the city of Philadelphia needs the money for its purposes; so, the city of Philadelphia borrows short term against receivables.

Chairman HUMPHREY. And it has to pay interest.

Mr. HOROWITZ. It has to pay.

Chairman HUMPHREY. So, you have a double deal here, they get it from both sides. They don't get the interest from the Federal Government for services performed, and they have to pay interest for the issues.

Mr. HOROWITZ. There also are legitimate purposes for selling short term. I mean, for construction or the like, you sell in the beginning for short term, the way you do it in the normal market. It is certainly legitimate.

Mr. MOAK. I want to underline this problem. In February of this year as director of finance in Philadelphia I borrowed $110 million to carry me over the lowest point in our revenue structure for the year. Of that $110 million, $35 million was borrowed because of accounts receivable from the State and Federal Government, one-third.

Chairman HUMPHREY. Accounts receivable are not interest bearing.

Mr. MOAK. They are not interest bearing.

Chairman HUMPHREY. That just about concludes it here. This is a point that has been of some concern to the committee, as we prepared for this hearing. We noticed that in the past 5, 6, or 7 months the ratio of interest rates on tax-exempt securities that we have been speaking of, as to the interest rate on corporate securities, has risen as much as 15 percent.

Because interest rates on municipal bonds are rising, while corporate bonds are declining, why are the relative interest costs of municipal securities rising so quickly, and particularly as compared to the corporate bonds?

Mr. HOROWITZ. A couple of reasons. If you take a AAA municipal bond and a AAA corporate bond, it is not so——

Chairman HUMRPHEY. Well, once you get rid of the AAA level.

Mr. HOROWITZ. You take B–AA bonds against B–AA bonds you find that the one thing about our market—we have a chart here which I will be happy to submit, if you wish.

Chairman HUMPHREY. We have a copy of that chart.

Mr. HOROWITZ. If you look at that chart on bonds, on the right where it compares B–AA municipal against B–AA corporate, you see under the asterisk—corporate can't come to the market at all, they are pushed out of the marketplace.

Chairman HUMPHREY. You mean there are no offers on the municipal.

Mr. HOROWITZ. No, corporates.

Chairman HUMPHREY. No corporate.

Mr. HOROWITZ. I must admit, I am taking advantage of the questions, talking about the municipal market—there are no corporate B–AA, there are B–AA municipal.

Also, the figures used in the average are affected by the credit, affected by the Urban Development Corporation, and the New York City problem which, as the article in the Wall Street Journal said yesterday, cities are affected because people have become suspicious. And one of the ways you will allay their suspicions is if you pay them more. In other words, money is a commodity, like everything else.

If you put a bigger and better price on it, a person buys; that is, put a higher price on it, by raising the interest rate.

These AAA securities and good AA securities in this market have suffered some in comparison with corporate, but that, I would say, more because of the absence of certain types of buyers.

Chairman HUMPHREY. The absence of the bank buyers.

Mr. HOROWITZ. I want to say parenthetically that the absence of bank buyers in the municipal market has helped the Treasury because banks have bought Government bonds and these U.S. Government bonds have been sold in great size in the past few months.

But there is no question that the lower rate municipals vis-a-vis the corporate are affected and the yield spread was greater in the past, vis-a-vis, what the yield spread is now, and that has to do with the quality.

Chairman HUMPHREY. Mr. Moak, do you have any comments?

Mr. MOAK. Well, I would concur with what has been stated here, and this ruboff affects Philadelphia, also. We sold gas revenue bonds last week, and we had to pay 7.9 percent for 20-year bonds, which is in part due to the situation arising out of New York City—it rubs off on the older core cities, particularly those in the East.

I suspect if I went to an incorporated town out in Arizona and did my financing through it, I could sell my bonds for a better price than I can in Philadelphia.

Mr. HOROWITZ. Can I say something about Mr. Moak, and it has nothing to do with this hearing. I must admit that Mr. Moak and I are very old friends. Mr. Moak is the city director of Philadelphia. And there is one city in all the United States during these difficult times that had its rating raised, and that is the city of Philadelphia. And I would say that is a great credit to Mr. Moak. I think that you have a man here that knows something about municipal bonds.

Chairman HUMPHREY. We are very fortunate to have him, and we will be consulting with him as we continue to review this.

By the way, how are the municipal bonds rated for Minneapolis?

Mr. HOROWITZ. AAA, and the State of Minnesota is AAA, also.

Chairman HUMPHREY. That's good.

I remember one of the joys of my life was when I was a young mayor coming down to New York, signing up all these bonds. That is the only time that the Chase Manhattan Bank gave me a free lunch. [Laughter.]

And I want you to know, I enjoyed it. I don't know whether under the new morality that would be permitted, but I enjoyed it, and I would do it again.

Thank you very much; if you don't mind, gentlemen, we might want to burden you by sending you an inquiry on the questions we didn't get a chance to ask, or that we didn't realize we should ask today; and we are grateful to you.

The committee stands adjourned.

[Whereupon, at 12:50 p.m., the committee adjourned, subject to the call of the Chair.]

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