



STATE OF NEW YORK
OFFICE OF FEDERAL AFFAIRS

~~JANESVILLE~~

~~ROCKY HILL~~

BRAD C. JOHNSON
Acting Director

December 30, 1977

444 NORTH CAPITOL STREET, N.W.
WASHINGTON, D.C. 20001
(202) 638-1311

Mr. Eugene Keilin
Executive Director
Municipal Assistance Corporation
Two World Trade Center
New York, New York 10047

Dear Mr. Keilin:

As you develop legislative proposals for continued federal assistance to New York City, you may find the enclosed documents helpful. The documents consist of the two bills, plus the reports, which the House and Senate Banking Committees approved in 1975, just before President Ford ended his opposition to any form of New York City aid, and recommended the present seasonal loan program.

The House bill, H.R. 10481, as reported to the House on November 6, 1975, would have created a five man board, composed of the Treasury Secretary, the HUD Secretary, the HEW Secretary, the Chairman of the Federal Reserve, and the Chairman of the SEC. Under the terms of the bill, the board would have the authority to grant federal guarantees of State bonds designed to assist financially pressed cities. The Senate bill would have provided for the same authority, under much the same circumstances and requirements (see below). However, the State would be obliged to meet only one-third, rather than one-half, of the city's operating deficit, and the State could do so by means of a loan, rather than by a grant. The Senate bill would have required the State to meet one-half of the city's deficit by means of a grant.

Rather than the four to five year phase-out planned by the Senate bill, the House bill would authorize \$5 billion of outstanding guaranteed bonds until September 30, 1989, and \$3 billion thereafter, until September 30, 1999. Moreover, the State would be liable to make up federal losses only to the extent of federal revenues flowing to the State (e.g. revenue sharing funds), rather than reimbursing the federal government in toto for losses.

A mandatory exchange of MAC bonds and city securities would have been authorized by the House bill, but the precise terms and conditions of such an exchange would have been left up to the board. Unlike the Senate bill, the House bill would not have required the voluntary approval of the security holders.

Finally, the Senate bill would have permitted the federally guaranteed bonds to be taxable or non-taxable, depending on the amount of the guarantee fee paid by the State. The House bill would not have permitted a taxable bond option. All interest on guaranteed bonds would have been taxable.

The Senate bill, S. 2615, provided for short term (one year) federally-guaranteed State bonds to finance the credit needs of a city if neither the State nor the city could obtain private credit and if either one was in danger of default. In order to qualify, the city would have to file a plan under which it could achieve a balanced budget within two full fiscal years, and would have to submit to State control of its fiscal affairs. The State would be obliged to pay a guarantee fee to the federal government, reimburse the federal government for any losses, and, if necessary, make a grant to the city equal to at least one-half of the city's operating deficit, above and beyond prior State assistance programs. Moreover, bond and note holders representing 65 percent of any obligations issued by a State agency on behalf of the city (MAC bonds) would have to agree to exchange existing bonds for federally guaranteed bonds with a later maturity date. The same agreement (but with the lower limit of 40 percent) would be required of the city's own bond and note holders for obligations maturing prior to June 30, 1976.

The federally guaranteed obligations would be limited to \$4 billion the first year, \$3.5 billion the second year, \$2.5 billion the third year, and decreasing at last to \$1.5 billion in the fourth year, after which the program would end.

In the case of a city which could not meet all of the necessary requirements outlined above, has defaulted or petitioned for bankruptcy, and is in danger of eliminating essential services, the bill would authorize federal guarantees of the city's own bonds, and the State would not have to reimburse the federal government for losses. However, only \$500 million of guaranteed bonds could be outstanding at any one time, and no obligations with maturity dates of more than three months could be guaranteed. Authority to make these emergency guarantees would have expired very quickly, on March 31, 1976, whereas authority to make the larger, pre-default guarantees would not have expired until June 30, 1979. Otherwise, the features of the two programs are similar.

Both of the programs under the Senate bill would be administered by a three man board consisting of the Treasury Secretary, the Labor Secretary, and the Chairman of the Federal Reserve. Because it was anticipated that the State-paid guarantee fees would produce a profit, the bill would have established an emergency municipal debt fund to provide money for the guarantee programs, with supplements from the Treasury as needed.

If you have any questions, or wish for further information, please do not hesitate to call. Best wishes for the New Year.

Sincerely,



Brad C. Johnson

BCJ:plw
Enclosures

December 23, 1977

The President
The White House
Washington, D. C. 20500

Dear Mr. President:

The Committee on Banking, Housing and Urban Affairs held oversight hearings on the New York City Seasonal Financing Act on December 14, 15 and 16, 1977. Pursuant to those hearings, a Committee Report outlining the findings and recommendations will be issued sometime in January. However, we thought it advisable to inform you of our own views as quickly as possible, since they may have a bearing on the decisions you will soon have to make regarding Administration policy on the New York City financing issue. As you know, the present \$2.3 billion Federal seasonal loan program expires on June 30, 1978.

Witnesses at our oversight hearings gave a clear signal that New York City will be seeking and expecting an extension of the seasonal loan program beyond June 30, 1978, and will likely be requesting some long-term financing assistance as well. It was stated or implied repeatedly that the City needs such additional aid or else it will go bankrupt after June 30.

Based on information obtained in the hearings and elsewhere, we are yet to be convinced that further financial assistance from the Federal Government is needed for New York City to be able to meet its financing needs and avoid bankruptcy after June 30, 1978. There are resources available to New York City and New York State which should be sufficient to maintain solvency regardless of what the Federal Government does. And since it is by no means certain that Congress will approve any additional Federal aid to New York City, we think it is essential that alternative sources of financing be given serious consideration at the present time.

We should note as well that the political and economic climate that is likely to prevail in mid-1978 will be considerably different from that of late 1975. In 1975, New York City's finances veered toward chaos and no resolution of the problem seemed possible absent Federal involvement. In 1978, the size of the financing problem will have been considerably reduced, and the City's record of significant progress on a number of issues —

budget balance, accounting reforms, cuts in payroll and programs — can be expected to put it in a better position to sell its securities. Thus, we would judge that the probability of the financial community stepping in to assist New York City following the expiration of the Federal seasonal loan program is considerably greater. Furthermore, there will be in office a new mayor who has stated firmly, in a letter produced for the Committee's hearings, "there will be no bankruptcy for the City of New York."

There are several steps which we believe New York City can and must take in order to be in a position to meet its financing needs without reliance on the Federal Government. These include achieving real budget balance and taking other actions necessary to assure investors of the security of the City's obligations. In our view, these conditions can and must be met in the next three to four months, or else the City will face grave consequences whatever the Administration and Congress decide to do. With this as a premise, we shall elaborate on the City's expected financing needs over the next three years, both long-term and short-term, and the resources available for meeting those needs outside the Federal Government.

First, the oversight hearings revealed a universal and unequivocal view that New York City must achieve a credibly balanced budget and thus allay the fears caused by the magnitude of the deficit projections for fiscal year 1979. This will require the development of a detailed financial plan which demonstrates the City's ability to achieve recurring budget balance over at least the next three years. As we see it, this plan would have to include the following elements, among others:

1. a schedule for phasing out all of the operating expenses contained in the capital budget (presently about \$643 million) over the period of time covered by the financial plan;
2. a signed City-wide agreement on the economic terms and budget costs of the City employee union contracts over that period; and
3. a commitment from New York State to provide substantial additional amounts of financial aid to the City during that period, in order to enable the City to attain recurring budget balance.

We should like to underscore this third point, regarding the role of New York State. Figures obtained by the Committee indicate that during the years of the fiscal crisis and the years of the Federal loan program, that is, fiscal years 1976 through 1978, the amount of State aid to New York City has remained virtually unchanged. The increase during that period has been less than 4 percent, not nearly enough even to keep up with inflation. During that same time period, Federal aid to New York City has gone up markedly, by about 28 percent. In fiscal year 1976, State aid to the City ran about 9 percent higher than Federal aid; now it is 14 percent lower. While there may be some question about the exact numbers, we understand that figures developed by the Treasury Department show a similar trend.

We believe that States have the primary responsibility for their cities under our Federal system, and we think it likely that you share this belief. However, we found in the hearings that not only does New York State have no plans to provide more budget relief to New York City, but in fact it is planning a general tax cut of some \$500 million. Although we can comprehend the arguments for some tax relief, we see no reason at all why New York State should not be required to shoulder far more of the burden of eliminating the City's budget deficit, possibly by bringing its funding of welfare and medicaid costs more into line with the practices of other States. And, while not wishing to belabor the obvious, we should note that it would be most difficult for anyone to persuade Members of Congress to vote additional Federal financial aid to New York City so that New York State residents and elected officials can enjoy the benefits of a tax cut while similar benefits may well not be available to their own constituents.

As a second major point, in addition to balancing the budget, New York City will have to satisfy certain conditions designed to secure sufficient investor confidence to allow the City to borrow on its own in the credit markets. Testimony at the Committee hearings indicated that there is basic agreement on the nature of these conditions within the financial community, and basic acceptance of the need for them by other parties concerned with the City's financing. The conditions can be summarized as follows:

1. Establishment of an accounting and budgetary control system which will produce reliable City financial statements developed in accordance with generally accepted accounting principles.

2. Outside audit of the City's financial statements by a reputable accounting firm on at least an annual basis, with reports made available to the public.

3. Establishment of an independent review mechanism, along the lines of the present Emergency Financial Control Board, with authority to require that the budget be balanced and that the City follow reasonable budgeting and borrowing practices.

The last of these, the review mechanism, will require action by the State Legislature, which also must consider and act on the proposal to increase the Municipal Assistance Corporation's borrowing authority by some \$3 billion. The other two are the City's responsibility and, indeed, are already in the process of being accomplished.

In our view, all of the above are essential conditions which must be met by New York City and New York State as rapidly as possible in the coming year. We would suggest April 1, 1978, as a reasonable deadline by which all of these should either be fully accomplished or firm commitments made to accomplish them over the three-year period.

With all of these elements in place, well in advance of the expiration date of the Federal loan program, we then believe that New York City would be able to obtain the financing it needs on its own and thus avoid the danger of bankruptcy after June 30, 1978. We shall discuss below the City's estimated financing needs, both long-term and short-term, over the next three years and the most promising sources of financing available to meet those needs.

In his testimony at the oversight hearings, Felix Rohatyn, Chairman of the Municipal Assistance Corporation, outlined for the Committee his estimates of New York City financing needs, both short-term seasonal and long-term capital needs, over the next three years. He also described his plan for meeting those

needs, which involves a phase-down of the \$2.3 billion in Federal seasonal loans and a phase-in of \$2.25 billion in Federal long-term lending over that three-year period. We will use the Rohatyn plan as a basis for discussing alternative sources for New York City's financing during that period.

A. Long-term financing.

The Rohatyn plan describes three areas in which long-term financing would be utilized over the next three years. The first and most basic is the City's capital budget, including the expense items which are to be phased out. Mr. Rohatyn sees the capital financing needs as running at the level of \$3 - 3.15 billion over the three-year period, or about \$1 billion a year. Based on our own estimates and on discussions with officials in New York City, we believe that those figures are somewhat high. It must be borne in mind that the \$1 billion annual figure includes a sharply declining level of operating expenses, which means therefore a sharply rising level of "true" capital spending. It is questionable whether New York City would have the capacity, let alone the resources, to gear up to a capital program of \$800 million or more within three years, from the present level of \$428 million, however great its needs may be. The following would seem to be reasonably realistic, in fact reasonably generous, estimates of the City's capital financing needs over the next three years, including both "true" capital and operating expenses on a phased-down basis:

	FY 1979	FY 1980	FY 1981
Capital	\$450 million	\$550 million	\$700 million
Expense items	\$500 million	\$350 million	\$150 million
Total	\$950 million	\$900 million	\$850 million

Thus we would reduce the overall estimate of long-term capital financing needs from \$3 billion or more to \$2.7 billion. Presumably these amounts might even be reduced further if need be, either by cutting down on capital investment or by speeding up the phase-out of the operating items, or both.

The question now is how the City would finance this \$2.7 billion capital budget. Mr. Rohatyn has said that MAC has the economic capacity under its existing bond resolutions to raise another \$2.5 to \$3 billion over the three-year period, assuming State authorizing legislation and favorable markets. This means that in the best case, MAC should be able to cover all of the City's capital financing needs. Even assuming the lower figure, it could still finance most and perhaps all of a stringent, bare-bones capital budget.

In addition to MAC, the City should also be able to count on some further financing assistance from its employee pension funds. We recognize the major contribution that the City employee pension funds have already made in shouldering the burden of New York City's long-term financing needs in the past three years, since the credit markets closed against the City. By June 30, 1978, the pension funds will have a total of \$3.844 billion invested in New York City securities, which amounts to 35.3 percent of their total assets. This includes \$2.53 billion invested pursuant to the November 26, 1975 Agreement. It may not be reasonable to expect the unions to increase substantially the proportion of their resources invested in long-term City bonds over the next three years, but neither would it be wise to encourage a significant decrease in their holdings at the very time the City may be most in need of a financing bridge to the long-term capital markets. Moreover, the financial fate of the pension funds will still be closely linked to that of the City. So whatever may be the expressed desires of the union leadership, we think it would be reasonable to expect the City employee pension funds at least to maintain their existing level of commitment to the City's long-term financing, which would involve the following actions:

1. Reinvestment of the amounts of their holdings which will be maturing over the next three years. According to our calculations, based on tables supplied by Jack Bigel, consultant to the pension funds, this would amount to a total of about \$700 million.

2. Investment of 35.3 percent of the new investable funds accruing to the pension funds over the next three years, thus holding constant the overall level of investment in long-term City bonds. It has been somewhat difficult to obtain projections of pension fund investable funds over the entire period, but we have made some rough calculations.

According to a memorandum submitted by Mr. Bigel, the City pension funds anticipate a cash flow surplus of \$380 million in the next fiscal year, 1979, but that amount is likely to be reduced by certain one-time expenses to a level of about \$150 million. One can extrapolate from this data to estimate that additions to investable funds in the succeeding two fiscal years, 1980 and 1981, would equal at least the \$380 million figure and would probably not be encumbered by the unusual expenses faced in 1979. Therefore, we calculate the additional investable funds to the City pension funds over the three-year period to be at least \$900 million. If the pension funds then were to maintain their existing 35.3 percent level of investment in City bonds, this would provide a minimum of \$320 million in additional financing for New York City's capital needs.

It is likely that an extension of P. L. 94-236 with some amendments would be needed to permit these additional City pension fund investments. If this is the case, then we assume that the Administration would request the necessary legislation in a timely fashion.

To sum up, we believe that sufficient long-term financing would be available for New York City in the next three years from sources other than the Federal Government to more than meet the City's basic capital financing needs. We estimate that at least \$1 billion could be supplied by the City employee pension funds, in addition to the \$3 billion Mr. Rohatyn has said could be obtained through MAC, for a total of around \$4 billion. This would not only be enough to finance a \$2.7 billion capital budget, but also possibly to do some of the other long-term financing actions mentioned in the Rohatyn plan, to which we would assign a lower priority. These are discussed below.

The Rohatyn plan designates two other uses for long-term financing over the next three years:

- \$600-800 million for restructuring City bonds
- \$750-800 million for bonding out the State advance

While these actions may be desirable, they do not appear to be essential to avoid bankruptcy, which is the focus of our attention. They should be placed in a category of actions to be taken if resources permit.

We would assign second place to the restructuring of some \$600-800 million in City bonds which will be maturing in the next three to four years. Although we have not been able to obtain precise data, we have been told that refinancing these bonds to stretch out the debt service over a much longer period of time would potentially provide budget savings to the City of up to \$200 million a year, amounts that could roughly offset the cost of phasing out the expense items in the capital budget. Alternatively, there could be some property tax relief. Thus it would seem desirable from a budgetary standpoint to do this restructuring, but only if the resources are there.

Finally, there is the matter of bonding out the State advance, which runs at \$750-800 million a year. We have mixed feelings about this. On the one hand, it would have the salutary effect of reducing the City's seasonal borrowing needs. With this and some other adjustments, the Rohatyn plan estimates that the City's present seasonal borrowing needs of about \$2 billion a year could be cut in half, down to \$1 billion. This would lower the City's debt service costs, and quite possibly facilitate its re-entry into the credit markets for short-term borrowing purposes.

On the other hand, this \$800 million seasonal financing is basically guaranteed the City, whereas the equivalent amount of long-term financing is not. Moreover, New York State would be the principal beneficiary of the bonding out of the advance; this would relieve the State of its present need to provide back-door seasonal financing and thus would improve the State's own borrowing picture considerably. All this runs somewhat counter to our view that the State should be more, not less, involved in the City's finances. While we would not oppose the bonding out of the State advance if it can be done with available resources, we would certainly not assign it top priority, and we would definitely oppose the use of Federal long-term financing to accomplish this purpose.

In conclusion, then, we find there is ample reason to believe that New York City could cover its long-term financing needs over the next three years from resources immediately available to it, even in the absence of any financial aid from the Federal Government beyond June 30, 1978. Furthermore, we would not preclude the possibility of the City's being able to do some long-term capital financing on its own, through offerings of new City bonds, at least in the latter part of the three-year period.

However, this is not essential to the basic aim of meeting the City's long-term financing needs.

B. Short-term financing.

The Rohatyn plan estimates that New York City's short-term seasonal financing needs over the three-year period will amount to \$1.8 billion a year if the State advance is not bonded out, or \$1 billion a year with the bonding-out. We see no reason why these amounts should not be forthcoming from sources other than the Federal Government, for the following reasons among others:

1. The security for those seasonal borrowings is strong, since they are all geared to anticipated revenues from the State. The State's credit is strong, and there are statutory or other express commitments to providing these revenues over at least the next three years.

2. The City has an impeccable record of repaying its seasonal loans from the Federal Government in full and on time or ahead of schedule. There is little reason to believe that other investors could not feel assured of a similar repayment record. Furthermore, with the Federal Government out of the picture, there would be no impediment to repayment arising out of any express or implied prior lien on revenues by the Federal Government.

In our view, New York State should be looked to as the principal source of seasonal financing until such time as these needs can be fully met in the private markets. Governor Carey has told the Committee repeatedly that the State Constitution prohibits lending to a municipality. However, a memorandum from State Comptroller Levitt which the Governor submitted to the Committee a year ago gives some indication that the Constitution may not bar lending for short-term seasonal purposes. The memorandum stated, in part, that "the present Constitutional ban on gifts or loans of the State's credit precludes borrowing to assist the City except by notes payable within a year out of current revenue." (emphasis added) The latter phrase would appear to describe rather clearly the nature of seasonal borrowings and would suggest that the State might be able to assist the City directly in meeting some of those short-term needs.

Even if there might be some additional legal impediments to direct State financing, there is no legal barrier to the State pension funds' picking up substantial amounts of the City's short-term notes. These State pension funds hold very considerable assets, and the Committee was informed in the oversight hearings that they have made no real commitments to the City's financing, either short-term or long-term. Given the importance to the State and its public employees of New York City's avoiding bankruptcy -- an eventuality which could imperil the State's finances as well -- we see every reason to expect that the State pension funds should be able to backstop the City's seasonal borrowing needs, to the extent that they cannot be met in the private markets.

There are two State pension funds: the general State employees retirement fund, which has total assets of \$9.2 billion, and the teachers' retirement fund, with total assets of \$5.8 billion. Neither has any significant holdings of either New York City bonds or MAC bonds. Even if the pension funds were to pick up the whole \$1.8 billion in seasonal financing, which may not be feasible, this would amount to only 12 percent of their assets. This would be far smaller than the commitment made by the City pension funds, and it would be on obligations whose quick repayment is assured and at attractive rates of interest. As an additional note, we assume that this type of commitment to seasonal financing would not preclude State pension fund investments in MAC bonds as well. In fact, we believe that these pension funds should be urged to make such investments in amounts that are reasonable in light of the size of their assets and the make-up of their portfolios. Should Federal legislation along the lines of P. L. 94-236 be needed to permit these State pension fund investments, we assume the Administration would request such legislation in a timely fashion.

Finally, we come to the role and responsibility of the New York banks and other financial institutions in meeting New York City's financing needs. The total domestic assets of New York State commercial banks, savings and loan associations, and savings institutions were approximately \$305 billion as of June 30, 1977, and approximately \$247 billion of those were assets of financial institutions headquartered in New York City. From these figures, it is evident that it is well within the means of the New York financial institutions to cover much or all of New York City's

December 23, 1977

seasonal financing needs, which equal far less than one percent of their assets. The only question is whether the condition of these institutions and of the City would permit such a level of investment.

We feel there is every reason to believe that financial institutions located in New York City and in New York State are in a far better position now to take on more New York City-related obligations than they were in 1975, for several reasons. First, the economy is in better shape now, and the financial strength of the banking industry has improved. Second, the banks hold no short-term City notes at all at the present time, nor are there any such obligations still outstanding or in default. Third, the City has made tremendous strides toward putting its financial house in order in the past three years and will do still more in the next few months. Fourth, the banks can look to the record of repayment of the Federal seasonal loans as a firm indication that the City will live up to its commitments and repay its borrowings. Fifth, although the recently attempted City note offering failed due to the MIG-4 investment rating, it is important to recall nonetheless that the Comptroller of the Currency and the Federal Reserve Board both declared the notes to be eligible investments for the banks they regulate. For all these reasons, we think it reasonable to expect the banks and other financial institutions in New York City and New York State to pick up a substantial volume of short-term City notes over the next three years, and significant amounts of long-term MAC and new City bonds as well.

The Committee received testimony at the oversight hearings from the heads of six of the largest banks in New York City -- Citibank, Chase Manhattan, Morgan Guaranty, Bankers Trust, Manufacturers Hanover, and Chemical Bank. These banks alone represent total capital of \$10 billion and total assets of \$123 billion. Among them, Chemical Bank had by far the largest holdings of New York City and MAC bonds -- about \$342 million, or 1.9 percent of assets. The other banks had a much smaller proportion of their holdings in these obligations, and there is every reason to assume that they could invest in far larger amounts of MAC and New York City obligations, particularly new short-term notes, without jeopardizing their financial condition. Certainly, there is no reason to assume that such

investments would be any more risky than some of these banks' foreign loans, which consume a far larger proportion of assets. And although the bankers who testified were reluctant to make firm commitments, they did indicate that they would do their share in any future efforts to meet New York City's financing needs.

It is apparent, then, that we are skeptical about the need for continued Federal financial assistance to New York City. Moreover, we also believe that a renewal of the New York City loan would not necessarily serve the best interests of the Federal Government or the nation. First of all, continuing the loan program might encourage other municipalities to look to the Federal Government for similar financial aid in times of economic stress. While the Federal Government has an obvious role to play in assisting cities through its various grant-in-aid programs, a dangerous precedent would be set if the Federal Government became viewed as the ultimate guarantor of the fiscal solvency of municipalities. Such a precedent would certainly weaken the incentive for local self-discipline and erode the foundation of our Federal system.

Secondly, we believe a continuation of the Federal loan program will of necessity involve both the Congress and the Executive Branch in making judgments on the internal affairs of New York City which, under our Federal system, should be the responsibility of local officials. We do not believe Federal officials should be forced to get involved in highly controversial local matters such as wage rates for municipal employees, State or city tax cuts, tuition charges for city universities, subway fares, rent control, or salaries for members of the city council. Indeed, Members of the Senate Banking Committee have taken a good deal of personal criticism for speaking out on these issues. However, as long as we have Federal financial involvement in the affairs of New York City and the need to safeguard the Federal investment, we believe that both the Congress and the Executive Branch will have to take highly unpopular positions from time to time. In the long run, it is much better to have these decisions left to the City and the State without involving the Federal Government.

December 23, 1977

We realize that our views may not be well received by some. Witnesses at the oversight hearings, including those from the financial community, expressed the view that extension of the Federal loan program in some form is necessary, and some of them clearly espoused the Rohatyn position that long-term Federal financing is needed as well. We believe it is vital that the contrary position be considered and weighed carefully, both in the interest of responsible public policy and in the interest of New York City's financial survival after June 30, 1978.

Mr. Rohatyn has stated that simply extending the Federal seasonal loan program would be the "application of a band-aid to a continually bleeding wound." We believe, on the contrary, that it would be a continuing crutch for a patient that should be made to walk again.

We hope that the points raised in this letter will be a part of your deliberations on Administration policy toward New York City in the coming year.

Best wishes for the holiday season.

Respectfully,

William Proxmire
Chairman

Edward W. Brooke
Ranking Minority Member

BACKGROUND: H.R. 6419
THE FEDERAL MUNICIPAL BOND GUARANTEE ACT OF 1977
INTRODUCED BY CONGRESSMAN FRED RICHMOND (D-N.Y.)

Once again, the nation has been hearing about New York City's fiscal crisis. At the same time, there is a growing recognition that there is a broader national crisis for local government units all across the country. Like New York, municipal and county governments are finding it increasingly more difficult to raise the money they need for capital improvements and other essential expenditures. It is as yet unclear if the President's long-awaited urban policy proposals will resolve the fiscal "crunch" for local government.

A recent New York City note sale collapsed due to the unwillingness of the market to absorb City notes. In recent testimony before the Senate Banking, Housing and Urban Affairs Committee, Felix Rohatyn, Chairman of the Municipal Assistance Corporation for the City of New York, stated:

"This occurred even though there was little question as to the actual security of the notes. The unwillingness of the market to absorb City paper of reasonable security, short maturity and very moderate size, bodes ill for the City's ability to finance not only short-term but long-term as well . . . I believe the failure of the City note sale reflects a market whose skepticism with respect to any kind of City paper is extreme."

The single most important element in the resolution of New York City's fiscal and credit problems is some form of federal guarantee for City bonds. However, New York is not the only local government with serious unresolved problems. The situation is serious enough to require federal action to guarantee bonds issued by any local government.

In the 94th Congress I introduced H.R. 7517 which would establish a Federal Municipal Bond Guarantee Administration (FMBGA) modeled after the Federal Deposit Insurance Corporation.

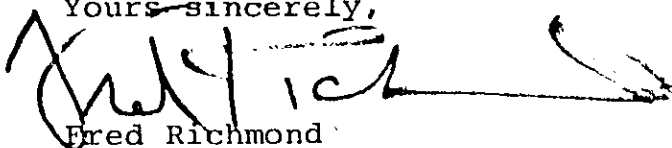
Briefly, FMBGA would work like this: Following certification that the local government issuing the bond was operating in a responsible manner, the Administration would guarantee both the principal and interest of those municipal bonds. The cost of administering this program would be paid by assessing the local governments who participate an amount proportional to their use of the program. In addition, in order to provide an insurance fund, local governments who desire federal guarantees would be required to deposit security with the FMBGA. This would mean that instead of each municipality keeping its own reserve fund, a joint reserve fund would be established. The resulting savings of this system would accrue to local taxpayers all over the country who would benefit from lower local government costs. In addition, the federal government would receive the benefits of narrowing the ever-widening tax loophole which permits purchasers of municipal bonds to escape income taxes on their interest.

This is not a unique service that the federal government would provide to an important credit market. There are already federal guarantee administrations for banks (FDIC), credit unions (FGUGA), farmers (FCB), and savings and loan associations (FSLGA). It seems no less appropriate for the federal government to help the local government units of the nation in the same way.

In the first session of the 95th Congress I introduced H.R. 6419, a measure which is identical to H.R. 7517, except for the added clarification that the interest on these federally guaranteed municipal bonds shall be treated as taxable income.

Should you require any additional information, please contact Arthur Craig of my Washington office (202) 225-5936.

Yours sincerely,



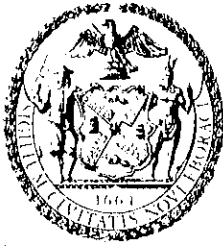
Fred Richmond

The City of New York

Office of the Mayor
New York, N.Y. 10007

First Deputy Mayor
Donald D. Kummerfeld

Fed. Guar. 1978
NYC



November 30, 1977

FOUR YEAR FINANCIAL PLAN

FOR NEW YORK CITY

A consensus is emerging among City, State and Federal officials that the City will not be able to meet all of its seasonal financing requirements in the public credit market after June 30, 1978, even though it is meeting all required fiscal targets. Further, it is recognized that neither the employee pension funds nor MAC have sufficient resources or authority to meet the City's legitimate need for long term financing in the next few years. Hence, there is need for a Federal role in both seasonal and long term financing in the next 3 to 5 years as the City gradually reenters the credit markets.

To achieve the necessary legislative support for a new short and long term Federal financing program for New York City, it is essential that there be a carefully devised financial plan supported by the new Administration, the City Comptroller and the State which leads to full self sufficiency for all of the City's credit requirements by the end of the financial plan period. Thus the Congress would have assurance that the Federal role was strictly temporary - i.e. to supplement the City's presently

limited ability to raise private capital as it gradually re-establishes investor confidence and full market access.

To be credible the financial plan must deal realistically with four problems:

1. How the City will achieve a balanced budget over the next four fiscal years while accelerating the phase out of capitalized expenses [as required by the Treasury] with reasonable expectation that the budget will be in recurring balance in the years thereafter.
2. What is the City's projected need for seasonal financing in the next four years and how much of this can the City expect to obtain in the public market.
3. What are the City's needs for long term capital financing during the next four years and what sources other than Federal loans or guarantees might be available.
4. What structural and legislative changes are required to assist the City's return to the public markets (e.g. oversight mechanisms, segregation of real estate taxes for debt service, limitations on short term borrowing, etc.)

Budget Balancing

Since the City's revenues at current tax rates are growing less rapidly than inflation in costs for current levels of goods and services, the City will, in order to balance its budget each year, have to achieve some combination of increased revenues (probably from State and Federal Sources) and further reductions in expenditures (hopefully from increased management efficiency and labor productivity and possibly from reduced debt service through debt restructuring). The four year plan will project revenues at current or known future tax rates and estimate expenses at current service levels with appropriate inflation assumptions to arrive at annual budget gaps to be closed. It will include an accelerated phasing out of capitalized expenses so that at the end of the four year period there would be no such expenses remaining to be financed with borrowing. A balanced program of increased federal and state aid combined with expenditure reduction which is sufficient to close the budget gap will be set forth. It should be noted that this program will to some extent put the State and Federal governments on the spot so that they would be implicitly supporting higher levels of aid to the City through approval of the four year plan.

Underlying the four year revenue estimates will be key assumptions about the projected performance of the N.Y.C. economy - assumptions on which there may well be considerable disagreement. On the expense side, the key assumptions will be wage increases and inflation in welfare and Medicaid costs - also very sensitive

and controversial subjects.

Seasonal Financing

The plan will project seasonal financing needs over the next four years assuming the bonding out of the \$800 million State advance which is necessarily contingent upon long term Federal credit assistance. The ability of the City to finance increasing portions of total annual seasonal borrowing requirements over the four year period will be projected with declining annual Federal loan requirements indicated.

Long Term Financing

The plan will project long term financing needs over the next four years assuming the bonding out of the \$800 million advance noted above. [It should be noted that the \$800 million advance could be reduced during the four year period through the use of any end-of-year budget surpluses which may occur.] The plan will also include assumptions about a MAC borrowing role, the ability of the City to gradually reenter the long term bond market and the need for Federal loan guarantees over the four year period.

Ceiling on Federal Credit

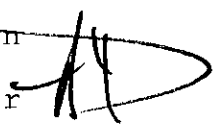
The plan will also include a ceiling on the total amount of Federal loans and loan guarantees which may be outstanding at any time during the four year period, including both short and long term lending.

Structural and Legislative Changes

The plan will include a commitment to certain structural and legislative changes designed to facilitate the City's reentry into the long term market. The safeguards to investors proposed in the City's negotiations with the clearing house banks last spring (points 1 - 9) provide an obvious starting point for such a commitment. But the key element will undoubtedly be the form and duration of an external oversight mechanism.

Municipal Assistance Corporation
For The City of New York

MEMORANDUM

Date : 23 November 1977
To : Eugene Keilin
From: Andrew Decker 
Re : Federally Guaranteed Debt Instruments

Some or all of the various debt instruments of the following agencies are guaranteed by the United States Government.

Student Loan Marketing Association
Postal Service
Department of Housing and Urban Development
 Federal Housing Administration
 Government National Mortgage Association
 New Communities Debentures
 Public Housing Notes and Bonds
District of Columbia Armory Board
Eximbank
Farmers Home Administration
General Services Administration
Maritime Administration
Small Business Administration
Washington Metropolitan Area Transit Authority

Particular attention might be focused on the New Communities Debentures issued by the Department of Housing and Urban Development, the District of Columbia Armory Board, and the Washington Metropolitan Area Transit Authority (WMATA).

New Communities Debentures are issued pursuant to Title IV of the Housing and Urban Development Act of 1968 and Title VII of the Housing and Urban Development Act of 1970. The program provides federal guaranties for debt issued to foster the development of balanced new communities. At December 31, 1975, there were approximately \$280 million outstanding.

The District Columbia Armory Board, despite its name, was established to finance, construct and operate a stadium in Washington, D. C.

Debt issued by WMATA is guaranteed up to an aggregate amount of \$1,200 million. The debt has been issued in conjunction with the construction of the Washington Subway System.

HAD/mp



State of New York
Municipal Assistance Corporation
For The City of New York

Two World Trade Center
New York, N. Y. 10047

Eugene Keilin
Executive Director

Felix G. Rohatyn
Chairman

(212) 488-5720

Board Members
Francis J. Barry
George M. Brooker
Thomas A. Coleman
Thomas D. Flynn
George D. Gould
Dick Netzer
Robert C. Weaver

Writer's Direct Wire: (212) 488-_____

21 November 1977

TO: Governor Hugh L. Carey
SUBJECT: New York City Financing - Federal Role

The failure of the sale of City notes brings to the fore once again the question of City market access, both long and short term, as well as the appropriate Federal role after June 30, 1978 in providing financial assistance to the City.

It is our judgment that the City will be able to market short-term notes, in modest amounts, beginning in the summer of 1978, provided that:

- a) Satisfactory agreements are negotiated between the City and its unions in the spring of 1978, and the investments by the Pension Systems called for in fiscal 1978 are completed.
- b) A credibly balanced City budget is presented for fiscal 1979.
- c) A federal financing role after June 1978 has been defined and implemented.

Much more serious questions are raised with respect to City access to the long-term markets. It would be imprudent to think this could take place before greater credibility exists in the City's ability to balance its budget, combined with an acceleration of the phase-out of expense items from the City's capital budget, and increased confidence in the City's economy.

Governor Carey
21 November 1977
Page Two

There is no vehicle available, at present, to provide long-term financing to the City on reasonable terms beyond June 30, 1978.

The Municipal Assistance Corporation, following the Restructuring Agreement has the economic capacity under its existing bond resolutions to raise another \$2.5-3 billion over the next several years, provided the Legislature concurs and assuming favorable markets. While this economic capacity should be included in any long-term financing program for the City, we will indicate below that the City's needs for long-term financing are greater than the amount MAC can provide.

Another potential source of funds is the City's Pension Systems, whose present commitment to purchase City bonds expires on June 30, 1978. While it is possible that the Pension Systems might be persuaded to participate to some extent in the exchange of City bonds for MAC bonds which is an integral part of our financing program, we believe it unwise to count on the Pension Systems for new investments after June 30, 1978, since spokesmen for the Pension Systems have indicated their desire to scale down the 37% or so of their assets tied up in City and MAC obligations.

This should therefore, once more, lead to an examination of a Federal role in the long-term financing area. As you know, the Municipal Assistance Corporation has long held the view that such a role was not only necessary to the City, but also beneficial to the State and the Federal Government, as well. It may be difficult to persuade the Federal Government to accept these conclusions. However, we will continue our practice of giving you recommendations on the substance of the financing problem while recognizing that political realities may ultimately preclude their implementation.

Simple extension of the existing Federal Seasonal Loan Program would be the mere application of a band-aid to a continually bleeding wound. It is a bridge to nowhere. However, Federal long-term financing assistance would enable us to complete a series of actions which would make the City financially viable and capable of undertaking more vigorous action for its economic recovery.

The three-year plan recently evolved by Comptroller Goldin, consistent with the actions previously taken by the Municipal Assistance Corporation, contemplated the following:

- a) Refinancing on a long-term basis the current rolling \$800 million annual Spring advance from the State to the City. This advance is in reality a residue of past City deficits.
- b) Phasing out the expense items currently carried as capital items over three years instead of the remaining eight years allowed under existing State law.
- c) Extending the Federal Seasonal Loan on a scaled-down basis.
- d) Using the Municipal Assistance Corporation to do most of the City's capital financing for the next three years, coupled with moderate amounts of new City bond sales as well as reinvestment by the Pension Systems.
- e) Amending the Municipal Assistance Corporation legislation to expand MAC's responsibilities as a long-term fiscal monitor.

Several aspects of this plan are highly desirable, including the bonding out of the State advance and the accelerated phase out of expense items in the capital budget.

In addition, as part of the accelerated phase out of expense items, we believe the Municipal Assistance Corporation should refinance, on a long-term basis, some City bonds coming due in the next few years to permit the City both to lower its property tax rate and to provide budgetary relief. We estimate a need for refunding of some \$600-800 million of such City bonds through the Municipal Assistance Corporation.

We, therefore, see the following aggregate needs for long-term financing over the next three years:

\$3,000-3,150 million	for capital (including expenses)
600-800 million	for restructuring City bonds
<u>750-800 million</u>	for bonding out state advance

These needs should total approximately \$4,500 million over the next three years.

Governor Carey
21 November 1977
Page Four

We do not include in this total some \$750 million of possible refinancing of MAC's early, high-interest, short average life issues, which could provide another \$50 million or so of budgetary relief, but which would not count against our borrowing authority.

You can see from the above that the City's real needs are for 50% more than the amount which MAC is permitted to finance under its existing bond resolutions.

The prudent thing to do, in our judgment, would be to provide for the City's needs of \$4,500 million, half by public sales of MAC bonds under the existing First and Second Bond Resolutions and half by a sale of MAC bonds to the Federal Government under a new (Third) MAC Bond Resolution.

The rights of the holders of MAC's bonds issued under its First and Second Bond Resolutions would not be affected by issuance of Third Resolution bonds, which would be backed by City bonds held by MAC rather than by MAC's traditional revenue sources.

The purpose of the financings could be broken down roughly as follows:

\$800 million	State Advance
850 million	Expenses in Capital Budget
<u>600 million</u>	Restructure City Bonds
\$2,250 million	
<u>\$2,250 million</u>	Capital Construction
<u>\$4,500 million</u>	Total

The proceeds of MAC's sales to the Federal Government could be allocated to either half of this program, with public sales financing the other half. However, for present purposes, we are assuming the Federal loans will be used for the capital program.

The MAC issue sold to the Treasury would be a Third Resolution MAC, say of 25-year maturity, at the Treasury's interest cost plus say 1/4%, secured solely by a long-term City bond of similar terms and conditions. An additional component would be the creation of a long-term fiscal monitor of the City, which has been contemplated as a prerequisite to a public sale of City bonds, and which would also benefit the

Treasury as holder of the new MAC bonds. By securing such a MAC Third Resolution issue solely with a City bond, we would not impinge on the coverage of our First and Second Resolution bonds. The \$2,250 million of public MAC financings consisting of First and Second Resolution bonds would leave MAC with \$750 million of reserve borrowing power with which to handle other contingencies.

Assuming, as did the Goldin plan, a scaling-down of the Seasonal Loan, the Federal Loan program might consist of the following (in millions):

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>
Seasonal	\$1,750	\$1,000	\$ 250	\$ -0-
Long-term (aggregate issued)	<u>500</u>	<u>1,250</u>	<u>2,000</u>	<u>2,250</u>
Total	\$2,250	\$2,250	\$2,250	\$2,250

The City's current seasonal requirement is roughly \$2.0 billion. Assuming a gradual bonding out of the State advance and a smoothing of funding for the capital budget, total seasonal requirements should decline. After deducting the amount of Federal seasonal loans available in each year, the seasonal requirements to be raised by the City in the public markets would range from \$250 million or so in the first year to approximately \$1 billion in the third or fourth year.

These estimates may be conservative, and the City may actually exceed this schedule for reducing its need for Federal seasonal loans.

At the end of such a three-year program, the City's financing position would be:

- a) Bonding out the State advance will finance long-term this element of the City's past deficit.
- b) The City's total financing requirements will be \$2 billion each year instead of its current \$4 billion. Of this amount \$1 billion will be seasonal and \$1 billion capital.

Governor Carey
21 November 1977
Page Six

- c) Both the seasonal and capital financing requirements should be within the City's ability to meet in the public markets. MAC will still have some borrowing power left to supplement any shortfall.
- d) With expense items out of its capital budget, the City's overall budget will be truly balanced and its capital expenditures will result in true physical improvement and accelerated economic activity.
- e) The Treasury will have an investment of \$2.25 billion in a marketable bond which it should be able to liquidate, without undue market pressure, over the following three to four years. It will have made a profit on the financing and there could be an agreement to adjust the rate to a market rate at the time the Treasury resells its bonds.

We have discussed this approach with Comptroller Goldin and agreed to instruct our staffs to prepare a detailed plan which we could jointly propose to the City and the State and which could be the basis for our approach to the Federal Government. Steve Clifford and Gene Keilin have already started on this work.

Felix G. Rohatyn
Chairman

Eugene J. Keilin
Executive Director

1 (2) lack of public confidence in bonds issued by
2 municipalities and high interest rates have furthered the
3 financial troubles presently experienced by their local
4 government units;

5 (3) the tax-free status of municipal bonds carrying
6 presently high interest rates constitutes a severe revenue
7 loss to the Government of the United States;

8 (4) local tax revenues should primarily be directed
9 toward services within that particular municipality and
10 not to interest payments of outstanding bonds;

11 (5) stability in the bond market is important to
12 assure an increased growth of municipal services
13 throughout the Nation and insure the confidence and
14 protection of investors; and

15 (6) the policy of the United States in the past has
16 been to stabilize credit markets when national economic
17 conditions have brought about a situation that has en-
18 dangered an important segment of the economy.

19 (b) It is, therefore, the purpose of this Act to establish
20 the Federal Municipal Bond Guarantee Administration which
21 shall guarantee bonds issued by municipalities which are
22 operating in a fiscally responsible manner and to pro-
23 vide that the interest on any such guaranteed bonds shall
24 be treated as taxable income.

1 TITLE I—FEDERAL MUNICIPAL BOND

2 GUARANTEE ADMINISTRATION

3 ESTABLISHMENT

4 SEC. 101. There is hereby created a Federal Municipal
 5 Bond Guarantee Administration which shall guarantee, as
 6 hereinafter provided, bonds issued by municipalities which
 7 are determined by the Administration to be fiscally respon-
 8 sible and which apply to the Administration for guarantees
 9 of specific bond issues.

10 BOARD OF DIRECTORS

11 SEC. 102. (a) The management of the Administration
 12 shall be vested in a Board of Directors consisting of three
 13 members appointed by the President by and with the advice
 14 and consent of the Senate. A vacancy on the Board of
 15 Directors shall be filled in the same manner in which the
 16 original appointment was made.

17 (b) Not more than two members of the Board of
 18 Directors shall be of the same political party.

19 (c) (1) Except as provided in paragraphs (2) and
 20 (3), members of the Board of Directors shall be appointed
 21 for terms of six years.

22 (2) Of the members first appointed—

23 (A) one shall be appointed for a term of two years,

24 and

1 (B) one shall be appointed for a term of four
2 years,

3 as designated by the President at the time of appointment.

4 (d) Any member of the Board of Directors appointed
5 to fill a vacancy occurring prior to the expiration of the
6 term for which his predecessor was appointed shall be ap-
7 pointed only for the remainder of such term. A member may
8 serve after the expiration of his term until his successor has
9 taken office.

10 (e) Two members of the Board of Directors shall con-
11 stitute a quorum, but one may hold hearings.

12 (f) One of the three members of the Board of Directors
13 shall be designated by the President at the time of appoint-
14 ment to be the Chairman.

15 (g) The Board of Directors shall meet at the call of the
16 Chairman or a majority of its members.

17 ADMINISTRATOR AND STAFF; EXPERTS AND CONSULTANTS

18 SEC. 103. (a) The Administration shall have an Admin-
19 istrator who shall be appointed by its Board of Directors.

20 (b) Subject to such rules as may be adopted by the
21 Board of Directors, the Administrator may appoint and fix
22 the pay of such personnel as he deems desirable.

23 (c) Subject to such rules as may be adopted by the
24 Board of Directors, the Administrator may procure tempo-
25 rary and intermittent services to the same extent as is

1 authorized by section 3109 (b) of title 5 of the United States
2 Code, but at rates for individuals not to exceed the daily
3 equivalent of the annual rate of basic pay in effect for grade
4 GS-18 of the General Schedule.

5 **GUARANTEE OF MUNICIPAL BONDS**

6 **SEC. 104.** (a) The Administration is authorized, upon
7 application by a municipality, to guarantee as hereinafter
8 provided any bond to be issued by such municipality.

9 (b) To be eligible with respect to any bond issue to be
10 guaranteed under this section a municipality shall—

11 (1) pay to the Administration the cost to the
12 Administration of auditing, by contract or otherwise, the
13 municipality to assure that the municipality is able to
14 meet its fiscal responsibilities;

15 (2) be found by the Administration, on the basis
16 of the audit conducted pursuant to paragraph (1) and
17 any other information obtained by the Administration,
18 to be able to meet its fiscal responsibilities;

19 (3) provide to the Administration any information
20 which it deems necessary to make the findings required
21 by paragraph (2) and by paragraph (4); and

22 (4) remain, in the opinion of the Administration,
23 able to meet its fiscal responsibilities.

24 (c) Any municipal bond which the Administration

1 guarantees under this section shall be fully and uncondition-
2 ally guaranteed both as to interest and principal.

3 (d) In the event that any municipality shall not pay
4 upon demand, when due, the principal of, or the interest on,
5 any bonds guaranteed under this section, the Administra-
6 tion shall pay to the holder the amount thereof out of
7 moneys in the Municipal Bond Guarantee Fund established
8 under section 107 of this title.

9 EVIDENCE OF GUARANTEE

10 SEC. 105. Any contract of guarantee executed by the
11 Administration under this title shall be conclusive evidence
12 of the fact that a municipal bond issue is guaranteed by the
13 Administration.

14 PREMIUM CHARGES

15 SEC. 106. The Administration is authorized to fix pre-
16 mium charges for the guarantee of municipal bonds under
17 this title which, in the case of any municipal bond issue,
18 shall not be less than an amount equivalent to one-fourth of 1
19 per centum nor more than an amount equivalent to 1 per
20 centum of the amount of the principal obligation of the bond
21 issue.

22 MUNICIPAL BOND GUARANTEE FUND

23 SEC. 107. (a) There is established in the Treasury of
24 the United States a Municipal Bond Guarantee Fund which
25 shall be used by the Administration as a revolving fund for

1 carrying out the provisions of this title with respect to
2 municipal bonds guaranteed by the Administration under
3 section 104 of this title, and there shall be allocated imme-
4 diately to such fund the sum of \$ out of funds
5 made available to the Administration to carry out this title.

6 (b) All premium charges paid to the Administration
7 under section 106 shall be paid by the Administration into
8 the Municipal Bond Guarantee Fund.

9 ANNUAL ASSESSMENTS

10 SEC. 108. The Administration is authorized to assess,
11 once in each calendar year ending after the effective date of
12 this title, each municipality with respect to which bonds are
13 being guaranteed under this title an amount sufficient to
14 cover the estimated expenses (other than with respect to
15 the payments under section 104 (d) of principal and interest
16 on bonds guaranteed under section 104) of the Administra-
17 tion in carrying out this Act for its first fiscal year beginning
18 after the date of the assessment.

19 GENERAL OPERATING FUND

20 SEC. 109. (a) There is established in the Treasury of
21 the United States a General Operating Fund which shall
22 be used by the Administration to carry out this title (other
23 than with respect to making payments under section 104 (d)
24 of principal and interest on bonds guaranteed under section
25 104).

1 (b) All annual assessments paid to the Administration
2 under section 108 shall be paid by the Administration into
3 the General Operating Fund.

4 INVESTMENT OF MONEYS

5 SEC. 110. Moneys in the Municipal Bond Guarantee
6 Fund not needed for current operations of the Adminis-
7 tration related to guarantees under section 104 may be
8 invested in bonds or other obligations of, or in bonds or
9 other obligations guaranteed as to principal and interest
10 by, the United States.

11 POWERS OF ADMINISTRATION

12 SEC. 111. (a) The Administration may for the purpose
13 of carrying out this title hold such hearings, sit and act at
14 such times and places, take such testimony, and receive such
15 evidence, as it may deem advisable. The Administration
16 may administer oaths or affirmations to witnesses appearing
17 before it.

18 (b) When so authorized by the Administration, any
19 member or agent of the Administration may take any action
20 which the Administration is authorized to take by this
21 section.

22 (c) The Administration may accept, use, and dispose
23 of gifts or donations or services or property.

24 (d) (1) The Administration shall have power to issue
25 subpoenas requiring the attendance and testimony of witnesses

1 and the production of any evidence that relates to any
2 municipality which the Administration is empowered to in-
3 vestigate by section 104 (b). Such attendance of witnesses
4 and the production of such evidence may be required from
5 any place within the United States at any designated place
6 of hearing within the United States.

7 (2) If a person issued a subpoena under paragraph (1)
8 refuses to obey such subpoena or is guilty of contumacy, any
9 court of the United States within the judicial district within
10 which the hearing is conducted or within the judicial district
11 within which such person is found or resides or transacts
12 business may (upon application by the Administration)
13 order such person to appear before the Administration to
14 produce evidence or to give testimony touching the matter
15 under investigation. Any failure to obey such order of the
16 court may be punished by such court as a contempt thereof.

17 (3) The subpoenas of the Administration shall be served
18 in the manner provided for subpoenas issued by a United
19 States district court under the Federal Rules of Civil Proce-
20 dure for the United States district courts.

21 (4) All process of any court to which application may
22 be made under this section may be served in the judicial dis-
23 trict wherein the person required to be served resides or may
24 be found.

1 PAY OF THE BOARD OF DIRECTORS AND THE
2 ADMINISTRATOR

3 SEC. 112. (a) Section 5314 of title 5 of the United
4 States Code is amended by adding at the end thereof the
5 following:

6 “(65) Chairman, Federal Municipal Bond Guarant-
7 tee Administration.”.

8 (b) Section 5315 of the United States Code is amended
9 by adding at the end thereof the following:

10 “(109) Members, Federal Municipal Bond Guarant-
11 tee Administration.

12 “(110) Administrator, Federal Municipal Bond
13 Guarantee Administration.”.

14 RULES

15 SEC. 113. The Administration is authorized to prescribe
16 such rules as may be necessary or appropriate to carry out
17 this title.

18 DEFINITIONS

19 SEC. 114. For the purposes of this title, the term—

20 (1) “Administration” means the Federal Mu-
21 nicipal Bond Guarantee Administration.

22 (2) “Administrator” means the Administrator of
23 the Federal Municipal Bond Guarantee Administration.

24 (3) “Board of Directors” means the Board of

1 Directors of the Federal Municipal Bond Guarantee
2 Administration.

3 (4) "municipality" means a city, town, borough,
4 county, parish, or district created by or pursuant to the
5 law of any State of the United States.

6 (5) "municipal bond" means any bond issued by
7 a municipality.

8 AUTHORIZATION

9 SEC. 115. There is authorized to be appropriated such
10 sums as may be necessary to carry out this title for the
11 fiscal year ending September 30, 1978.

12 EFFECTIVE DATE

13 SEC. 116. This title shall take effect on the ninetieth
14 day beginning after its date of enactment.

15 TITLE II—AMENDMENT TO INTERNAL REVENUE

16 CODE OF 1954

17 TAXABILITY OF CERTAIN FEDERALLY GUARANTEED

18 OBLIGATIONS

19 SEC. 201. (a) Section 103 of the Internal Revenue
20 Code of 1954 (relating to interest on certain governmental
21 obligations) is amended by redesignating subsection (f) as
22 subsection (g) and by inserting after subsection (e) the
23 following new subsection:

1 “(f) CERTAIN FEDERALLY GUARANTEED OBLIGA-
2 TIONS.—Any obligation—

3 “(1) which is issued after the date of the enact-
4 ment of this subsection, and

5 “(2) the payment of interest or principal (or both)
6 of which is, at the time of issuance, guaranteed in
7 whole or in part under title I of the Federal Municipal
8 Bond Guarantee Administration Act of 1977,
9 shall be treated as an obligation not described in subsection
10 (a) (1).”

11 (b) The amendments made by subsection (a) shall
12 apply to taxable years beginning after December 31, 1977.

95TH CONGRESS
1ST SESSION

H. R. 6419

A BILL

To establish the Federal Municipal Bond Guarantee Administration to guarantee municipal bonds, and to provide that the interest on certain government obligations shall be taxable income.

By Mr. RICHMOND

APRIL 20, 1977

Referred jointly to the Committees on Banking, Finance
and Urban Affairs and Ways and Means

Fed. Guar. - Correspondence

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ANTHONY T. CLUFF, MINORITY STAFF DIRECTOR
MARY FRANCES DE LA PAVA, CHIEF CLERK

United States Senate

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
WASHINGTON, D.C. 20510

December 6, 1976

The Honorable Hugh L. Carey
Governor of New York
Executive Chamber
State Capitol
Albany, New York 12224

Dear Governor Carey:

In its Report on the New York City Loan Program, issued on May 17, 1976, the Committee on Banking, Housing and Urban Affairs unanimously recommended that New York State officials begin immediately to take any actions necessary, including amending the State Constitution, so that the State can lend to the City if it is unable to meet all of its credit needs in the private market after June 30, 1978. Otherwise, as the report noted, there is the potential for a New York City bankruptcy in 1978.

The question of the State's role in meeting the City's credit needs would appear to be even more pressing in light of the recent decision of the New York State Court of Appeals overturning the moratorium on repayment of \$1 billion in short-term City notes.

Nonetheless, I understand that to date no action has been taken to begin the two year process of amending the State Constitution, and none is planned. If this is the case, it is most disturbing, given the financial problems facing the City in the next two years. Thus I would appreciate your informing the Committee as to what actions New York State has taken or intends to take to

L
459-6600

LIAM PROXMIRE, WIS., CHAIRMAN
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United States Senate

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
WASHINGTON, D.C. 20510

KENNETH A. MC LEAN, STAFF DIRECTOR
ANTHONY T. CLIFF, MINORITY STAFF DIRECTOR
MARY FRANCES DE LA PAVA, CHIEF CLERK

December 6, 1976

The Honorable Hugh L. Carey
Governor of New York
Executive Chamber
State Capitol
Albany, New York 12224

Dear Governor Carey:

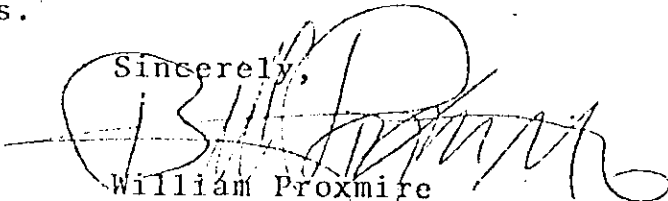
The Committee on Banking, Housing and Urban Affairs has scheduled oversight hearings on the New York City Seasonal Financing Act. The hearings will explore New York City's progress toward meeting its Financial Plan and toward resolving the problems posed by the New York State Court of Appeals decision overturning the moratorium on \$1 billion in short-term City notes. In this connection, you are invited to appear and testify on Tuesday, December 21, 1976.

The hearing will start at 10:00 A.M. and will be held in Room 5302, Dirksen Senate Office Building. It would be appreciated if you would submit to the Committee by 12:00 noon, Friday, December 17, fifteen copies of your prepared statement. In addition, for Committee and news media purposes, it is requested that you supply one hundred twenty-five copies of your testimony for distribution the day of your appearance. Be assured that your statement will not be released to the news media until your appearance before the Committee. Copies of your statement should be delivered to Ms. Rose Marie Fried, Room 5230, Dirksen Senate Office Building.

Your cooperation with the Committee rules will be greatly appreciated.

With best wishes.

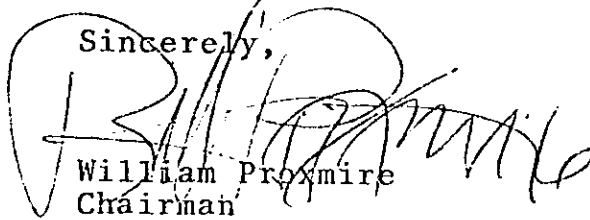
Sincerely,


William Proxmire
Chairman

help New York City meet its borrowing needs after the Federal loan program ends on June 30, 1978, should such assistance prove necessary.

Best regards.

Sincerely,

A handwritten signature in black ink, appearing to read "Bill Proxmire", written over the typed name and title.

William Proxmire
Chairman

CC: James L. Larocca
New York State Office

EMERGENCY FEDERAL FINANCIAL ASSISTANCE TO
PRIVATE ENTERPRISE: A SELECTIVE EXAMINATION
OF PAST LOAN AND LOAN GUARANTEE PROGRAMS OF
THE FEDERAL GOVERNMENT

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JOHN MITRISIN
Economist
Economics Division

November 29, 1974

EMERGENCY FEDERAL FINANCIAL ASSISTANCE TO PRIVATE ENTERPRISE;
A SELECTIVE EXAMINATION OF PAST LOAN AND LOAN GUARANTEE PROGRAMS
OF THE FEDERAL GOVERNMENT

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EMERGENCY FEDERAL FINANCIAL ASSISTANCE TO PRIVATE ENTERPRISE;
A SELECTIVE EXAMINATION OF PAST LOAN AND LOAN GUARANTEE PROGRAMS
OF THE FEDERAL GOVERNMENT

INTRODUCTION

The Federal government runs a number of programs which provide financial assistance to private enterprise. Some of these programs are of a permanent nature. Others are of limited duration intended to help a firm or industry through a crisis.

The permanent programs provide assistance to agriculture, housing, transportation, small business, and banks, among others. Many are an important source of credit for certain sectors of the economy. For example, the housing industry relies on the various Federal mortgage credit programs and the action of the Federal Home Loan Bank Board for a good portion of its funds, particularly in times of tight money. Agriculture receives credit assistance from the Farmers Home Administration and government sponsored credit corporations such as the Federal Land Banks and Federal Intermediate Credit Banks. Many of these programs were created during the 1930's to help various sectors of the economy through the depression. Instead of disappearing after the crisis, they have continued to operate, and have become an important part of the nation's credit structure.

Other Federal credit programs, both past and present, have not become an institutionalized source of funds. These programs have been of a temporary nature. Their aim has been to provide emergency financial assistance to firms or industries to help them overcome particular crises. With passage of these crises, the programs lapse.

The purpose of this report is to briefly examine a number of Federal programs which have provided emergency financial assistance to firms and industries to help them over a crisis. Its aim is to provide an understanding of the role

these programs have played in the past, and to give background on which to evaluate proposals for new emergency programs.

War Finance Corporation

The War Finance Corporation (WFC), at times considered a predecessor to the Reconstruction Finance Corporation, was created in April 1918 as an agency of the Federal government, and continued in existence until 1929. The initial purpose of the WFC was to provide financial support to industries in order to carry out World War I. It was created at a time when credit worthy firms were unable to obtain funds because of unsettled conditions in financial markets. After World War I the corporation was authorized to help finance exports, and was later a source of funds for agriculture.

The WFC provided credit through four mechanisms: (1) loans to banks which then loaned funds to private firms; (2) in exceptional cases loans directly to firms; (3) loans to savings banks, and (4) the buying and selling of government bonds. Funds to finance the corporation came from \$500 million in capital stock subscribed to by the Treasury and through the sale of WFC bonds on financial markets. In its lifetime the corporation sold \$500 million in capital stock to the Treasury and issued \$200 million in bonds.

Of the three major activities of the corporation--war financing, export assistance, and agricultural credit, the most important was agricultural credit. War financing lasted only from May to November 1918. During this time the WFC made advances of \$71 million. This relatively low volume of loans was due in part to the fact that the market for securities improved shortly after the corporation began its operations. As a result banks did not have to turn to the WFC for funds.

Export aid was authorized in 1919. From that year through 1929 advances

for exports totalled \$85 million. Advances for agricultural credit were authorized under the Agricultural Credits Act of 1921, and totalled \$297 million by 1929. These loans were authorized in response to the depressed state of agriculture brought on by the deflation and recession of 1920-1921. Agriculture, unlike most of the rest of the economy, was unable to overcome the recession. This was due to the increased worldwide agricultural production brought on by the demands of World War I and increased mechanization, and by the postwar reduction in demand accompanied by reduced prices. The purpose of the WFC agricultural credit program was to create confidence in the farm credit system. The corporation purchased agricultural loans which could not be sold elsewhere. It created a secondary market for these securities so that farmers and farm credit institutions had an opportunity to liquidate their indebtedness in a more orderly manner than would otherwise have been possible. The actions of the corporation helped avoid the failure of many banks and livestock loan companies. The work of the WFC and other government actions was not enough though to stop many rural bank failures during the 1920's, or to improve the depressed agricultural economy.

The agricultural loans of the WFC were made at market rates of interest. The loans were all secured by collateral substantially in excess of the amount of the loan. The corporation did not subsidize the cost of agriculture. Its purpose was to provide credit for sound purposes at a time when credit was not otherwise easily available.

Reconstruction Finance Corporation

The Reconstruction Finance Corporation was created under the Reconstruction Finance Act of 1932, and was amended a number of times until it was dissolved under the Reconstruction Finance Corporation Liquidation Act of 1953, which terminated the corporation's powers on September 28, 1953. The purpose and powers

of the Reconstruction Finance Corporation changed during the 20 years of its existence to match changing economic and political conditions. During the depression it was heavily involved in helping banks, railroads, agriculture, housing, private business and local governments avoid foreclosure, collapse, and bankruptcy. During the Second World War it was given almost unlimited powers to finance and where necessary run plants for national defense programs, deal in strategic or critical materials, acquire and dispose of facilities for the training of aviators, as well as other duties deemed necessary. The corporation worked in conjunction with other government agencies and RFC subsidiary corporations. For example, in order to carry out a particular objective, the RFC might make loans to industry to provide working capital for production. The Defense Plant Corporation, an RFC subsidiary, would construct and equip government owned facilities, and the Defense Supplies Corporation or Metals Reserve Company, both RFC subsidiaries, would carry out procurement and stockpiling activities and handle subsidy payments. After the war the RFC helped in the reconversion to a peacetime economy. It was later involved in spinning off its varied functions to government departments and independent agencies as it moved toward dissolution. The legacy of the RFC is still present in such agencies as the Small Business Administration, the Federal National Mortgage Association, the Commodity Credit Corporation, and the Export-Import Bank.

The RFC financed its operations through the sale of capital stock to the Treasury and by borrowing from the Treasury and the public through the sale of obligations. The original RFC legislation authorized the corporation to issue \$500 million in capital stock which would be purchased by the Treasury. In 1932 the total \$500 million was appropriated and used to purchase the capital stock. The RFC enabling legislation authorized borrowing from the public and the Treasury

of up to \$1.5 billion. This ceiling was increased over time so that eventually the RFC borrowed a total of \$54.4 billion, of which \$51.3 billion came from the Treasury.

From 1932 to 1953, the RFC, not including the activities of subsidiary corporations, was authorized to make loans and investments of \$46.5 billion. These funds were allocated in three ways: (1) loans and investments at the discretion of the RFC management, \$38.5 billion; (2) loans and investments made at congressional directive, \$7.2 billion; and (3) securities purchased from the Federal Emergency Administrator of Public Works, \$.7 billion. Of the \$46.5 billion authorized, the RFC disbursed \$40.6 billion, or 87 percent of the authorized funds.

Of the \$38.5 billion authorized for distribution by the RFC management, \$13.5 billion or 35 percent was to assist financial institutions, business enterprises, agricultural financial institutions and railroads. Of the \$33.3 billion actually disbursed by the agency through September 1953, \$8.9 billion or 26 percent went to these categories. The proportion of funds going to these areas is even higher if RFC's investments in wartime subsidiaries is not counted. In this latter situation, 78 percent of the authorized amount was for the categories listed above, and these categories received 72 percent of disbursements. Table I provides more detail on RFC disbursements.

The period of most active RFC involvement in providing credit assistance to firms and industries was in the 1930's. The powers and activities of the RFC as they existed during this time, and the way they were used to help the various sectors of the economy, will be the focus of the rest of this section on the corporation.

Table I

DISCRETIONARY LOANS MADE BY THE RFC MANAGEMENT

	Amount authorized	Disbursements to Sept. 28, 1953
Loans to and investment in financial institutions	\$4,815,324,697	\$3,906,201,681
Loans to business enterprises	5,153,294,815	2,637,329,690
Loans to agricultural financing institutions	2,454,133,430	1,452,502,107
Loans to railroads	1,059,867,787	938,440,875
Loans to and investments in <u>public agencies</u>	1,024,203,892	793,600,115
Investments in RFC mortgage <u>loan subsidiaries</u>	1,831,551,598	1,778,093,357
Loans to <u>foreign governments</u>	495,000,000	460,000,000
Investments in <u>Government agencies</u>	391,991,000	391,933,000
Other loans and investments	97,507,778	77,098,982
Investments in RFC's wartime subsidiaries	21,218,300,001	20,877,617,233
TOTAL	\$38,541,174,998	\$33,312,817,040

Source: U.S. Treasury Department, Final Report on the Reconstruction Finance Corporation, Washington, D.C., 1959, p. 48.

President Hoover, in signing the Reconstruction Finance Act into law in 1932, said that the RFC would have the resources to:

...strengthen weaknesses that may develop in our credit, banking and railway structure, in order to permit business and industry to carry on normal activities free from the fear of unexpected shocks and retarding influences.

Its purpose is to stop deflation in agriculture and industry and thus to increase employment by the restoration of men to their normal jobs.

By the end of the 1930's the RFC's authorizing legislation had been amended several dozen times. The corporation's purposes included the financing of agricultural, commercial, industrial and financial institutions, and the purchase of the preferred stock, capital notes or debentures of financial institutions. At the end of the 1930's the RFC was specifically authorized to make loans, advances, and other types of assistance to the following entities:

Financial institutions.

Railroads.

Insurance companies.

National mortgage associations, mortgage loan companies, trust companies, savings and loan associations, and similar financial institutions.

Public agencies and business enterprises.

Drainage and irrigation districts.

Businesses engaged in mining, milling, or smelting ores.

Managing agencies of farmers' cooperative mineral rights pools.

The fishing industry.

Victims of damage caused by catastrophes.

Those engaged in the marketing of agricultural commodities and livestock.

Those engaged in the exportation of agricultural or other products.

State insurance funds to pay injured workmen.

State funds to insure deposits of public moneys.

Processors, producers, and associations of producers who entered into a marketing agreement with the Secretary of Agriculture.

Receivers for taxes on farm real estate.

The Corporation of Foreign Security Holders.

The Federal Emergency Administration of Public Works.

The Federal Deposit Insurance Corporation. ^{1/}

The RFC concentrated its efforts on different sectors of the economy at different times during the 1930's. Financial institutions, business enterprises and railroads were some of the areas of prime concern to the corporation during the decade.

^{1/} For additional information on the RFC's powers see the Appendix.

Most of the RFC's assistance to financial institutions occurred between 1932 and 1934. During this period over three-fourths of the total amount disbursed to the financial sector was paid out. The reason for the high level of RFC activity in 1932, 1933, and 1934 was the precarious position of the nation's banking and financial system at the time. Between 1921 and 1929 the operations of 5,642 banks were suspended. In 1930-1931 there were 3,635 bank failures affecting the deposits of \$2.6 billion. The severity of the nation's banking problems eventually led to a ten-day nationwide bank moratorium in March 1933 immediately after the inauguration of President Roosevelt.

The Reconstruction Finance Corporation, along with the Treasury, the Comptroller of the Currency, and the Federal Reserve System, was part of a coordinated Federal effort after the bank holiday to shore up the financial and banking system. The RFC provided loans to weaker banks, and under the Emergency Bank Act of 1933 could purchase the nonassessable preferred stock of banks. During its lifetime the RFC disbursed \$3.2 billion in loans to banks and trust companies and purchased \$782 million worth of their preferred stock.

The RFC also had authority to make loans to mortgage loan companies, building and loan associations, insurance companies and credit unions. The corporation in the 1930's played an important role in helping the nation's financial institutions. Along with other Federal agencies operating at the time, it filled the roles now played by such institutions as the Federal Reserve System, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board.

The RFC was authorized to aid in the financing, reorganization, consolidation and construction of railroads after obtaining the approval of the Interstate Commerce Commission. Financial assistance could consist of direct loans, or the

The RFC also had authority to purchase railroad obligations from the Federal Emergency Coordinator of Public Works, later the Public Works Administrator. Under this program the RFC in 1935, 1936 and 1937 purchased \$200 million dollars worth of railroad obligations.

Evaluation of the effectiveness of the RFC program depends on whether one feels it was better to help finance railroads with Federal funds, or it would have been more appropriate to let some of them go into bankruptcy and reorganization. Advocates of the RFC argue that assistance helped keep the lines going, provided jobs, protected the stock and bond holders of the railroads, and prevented high rate increases. Critics maintain that reorganization in some instances might have been more efficient. According to one analysis, the RFC railroad loans:

...most certainly did not solve the problems of the weak railroads. They merely preserved, for a time, unsound, fair-weather financial structures. They created the unfortunate hope that ultimately a way would be found out of the financial morass without any necessary sacrifices by the creditor group. The carriers, thereby encouraged to await a turn for the better, made no move to eliminate their faults. They were confident that governmental assistance alone would guide them successfully through their troubles. 1/

Direct loans to business firms by the RFC were first authorized in June 1934. The original legislation as passed in 1932 was aimed at helping the national economy primarily through a strengthening of the nation's credit structure. The RFC's original lending activities, aside from railroads, were directed to the relief of financial institutions, primarily commercial banks, insurance companies, and mortgage institutions.

By 1934 the worst of the nation's financial crisis was past, but the demand for credit assistance to private firms remained strong. Congressional hearings in

1/ Herbert Spero, Reconstruction Finance Corporation Loans to the Railroads 1932-1937, Bankers Publishing Company, Boston, 1939, p. 141.

1934 indicated that the RFC had not succeeded in helping small businesses. Legislation in that year gave the corporation the power to make loans to business enterprises in addition to railroads and financial institutions. It was intended to provide credit to firms which were not being supplied by the banking system. An underlying assumption of the program was that the RFC loans would serve a different clientele.

Through June 30, 1947 the RFC non-defense loan program to business enterprises approved 30,775 loans, with a value of \$1,503 million. Of this authorized amount, \$598 million or 40 percent, was disbursed. The RFC provided four types of assistance to business enterprises: direct loans, immediate participation loans, deferred participation loans, and in a limited number of cases, the purchase of the capital stock or other obligations issued by a business concern.

Direct loans were authorized and serviced by the RFC. Immediate participation loans were made in cooperation with financial institutions. Deferred participation loans were disbursed and serviced by the financial institution, with the RFC agreeing to purchase a stated portion of the outstanding loan upon request.

Most recipients of the RFC funds received loans in the \$10,000 to \$100,000 range. This accounted for 47 percent of the number of loans made by the corporation between 1934 and 1951. In total dollars, these loans were only 20 percent of the loans disbursed, while 78 percent of the dollar amount went for loans of \$100,000 or more, and 50 percent went for loans of \$1 million and over. For more information on RFC loans see Table II.

Unless there was a reasonable prospect of repayment, the RFC did not make a business loan. The corporation's purpose was to meet the demand for funds which could not be met at the time because of deflation, liquidity problems, and

Table II

Distributions by Size of Loan and Term to Maturity for RFC Direct Business Loans Disbursed 1934-1951 and for Commercial Bank Term Loans to Business Made in 1946

LOAN CHARACTERISTICS	NUMBER OF LOANS		AMOUNT OF LOANS	
	RFC 1934-1951	Member Banks 1946	RFC 1934-1951	Member Banks 1946
SIZE OF LOANS				
Under \$1,000	2.0%	19.7%	b	0.4%
\$1,000-4,999	26.3	43.6	1.0%	3.8
5,000-8,999	14.5	18.0	1.6	8.2
10,000-24,999	21.7	10.7	4.3	5.1
25,000-49,999	18.2	4.1	5.7	4.2
50,000-99,999	12.0	2.5	9.8	5.0
100,000-499,999	6.2	2.4	19.0	16.3
500,000-999,999	1.1	0.9	9.3	12.4
1 million and over	1.0	0.8	49.5	49.8
TERM TO MATURITY				
1 year	8.1%	45.2%	8.5%	16.8%
2 yrs.	11.6		7.4	
3-4 yrs.	29.5	34.3	12.3	27.4
5-9 yrs.	43.9	17.8	41.3	47.5
10 yrs. and over	6.3	3.0	28.5	6.8
Other ^d	1.6	..	1.8	..
Total	100.0%	100.0%	100.0%	100.0%

RFC data are based on the National Bureau of Economic Research survey of RFC direct business loans exclusive of participations and national defense loans; for number and amount of loans, see Table B-1. Bank data are from a sample survey by the Board of Governors of the Federal Reserve System covering 2,000 member banks, and represent an estimated 119,800 term loans to industrial and commercial businesses made between November 1, 1945 and November 30, 1946 and still outstanding (to an estimated amount of \$3.2 billion) on the latter date; see "Term Lending to Business by Commercial Banks in 1946," by Duncan McC. Holtzhausen, *Federal Reserve Bulletin*, May 1947, Tables 8 and 14, pp. 503 and 513.

^a See classes, for RFC loans, refer to amount authorized; for bank loans, to amount outstanding.

^b Less than 0.05 percent.

^c The class intervals differ for the two samples as follows:

RFC	Member Banks
7-18 mos.	12-24 mos.
19-30	
31-54	
55-114	
115 and over	

^d Includes loans with terms of six months or less, and a few loans payable "on demand" or whose term to maturity was unknown.

Source: "An Analysis of the Business Loans of the Reconstruction Finance Corporation, 1934-1951," Federal Lending and Loan Insurance, Princeton University Press, Princeton, 1958, p. 435.

difficulties in the banking and finance industries. A study of the RFC business loan program, referred to in the study as the industrial loan program, concluded that:

From a qualitative analysis of its policy, it seems reasonably clear that the industrial loan program is essentially a supplementary source of credit, designed to meet a demand for inherently sound loans which for any reason other than a question of soundness, is not met by local banks.... The program ... has neither been conceived as being part of a 1/ deficit financing policy of the government, nor as a subsidy to industry.

Loan Guarantees Under Title V of the Interstate Commerce Act

Under Title V of the Interstate Commerce Act, which was in effect from August 1958 to June 1963, the Interstate Commerce Commission was authorized to guarantee, in the name of the United States, loans made to railroads for additions, betterments, and capital expenditures made after January 1, 1957, as well as for expenditures for the maintenance of railroad property. The maximum amount of all guarantees permitted was \$500 million.

During the operation of the program from 1958 to 1963, the commission approved 36 applications for loans from 15 railroads, and made loan guarantees totalling \$241 million. The purpose of the program was to provide financial assistance to railroads in the hope that their financial position would improve in time. The 1963 annual report of the Interstate Commerce Commission in looking at the program authorized by Title V found that:

Although the financial position of many of the Nation's railroads has improved since 1958, certain of the railroads in the eastern district are still operating at revenue and income levels below those experienced in 1957. It is apparent that some of these eastern district railroads have survived since 1958 only with the help of loans guaranteed under part V. 2/

1/ John Desmond Clover, "Industrial Loan Policy of the RFC," Harvard Business Review, June 1939, pp. 475-476.

2/ Interstate Commerce Commission, 77th Annual Report of the Interstate Commerce Commission, fiscal year ended June 30, 1963, Washington, D.C. 1964, p. 36.

Interim Emergency Financial Assistance Under the Railroad Passenger Service Act of 1970

Under Title VII of the Rail Passenger Service Act of 1970, railroads may receive Federal loans or guarantees to create a modern, efficient intercity rail passenger service system. The funds must be used to help carry out the intent of the legislation, and assistance must not be available from other sources. Loans and guarantees can run for a maximum of five years, and the aggregate amount of loans and guarantees may not exceed \$200 million. No loans or guarantees have been provided under the provisions of Title VII, and no foreseeable use will be made of the program.

Emergency Loan Guarantee Act

The Emergency Loan Guarantee Act of 1971 provided Federal loan guarantees to large business enterprises whose failure would seriously affect the nation's economy and the employment level. The program is administered by the Emergency Loan Guarantee Board which was created under the legislation. The board is made up of the Secretary of the Treasury, and the chairmen of the Federal Reserve System and the Securities and Exchange Commission. Under the legislation, the power of the board to enter into guarantee arrangements ended on December 31, 1973.

The board was given the power to decide if a firm was eligible to receive a guarantee. Eligible firms would have loans made to them guaranteed against loss of principal and interest. To be eligible, firms had to meet three qualifications: (1) the loan was required to permit the firm to furnish goods or services, and the failure to do this would seriously affect the economy or employment; (2) credit could not be obtained without a guarantee; and (3) the firm could with reasonable assurance be expected to repay the loan. The maximum amount of a guarantee to a firm was \$250 million.

Before its powers expired the board approved a loan guarantee for only one firm--Lockheed Corporation. The guarantee was for the maximum \$250 million. Providing a loan guarantee to Lockheed was the intent of the legislation. The program was not meant to be a source of funds for other corporations.^{1/}

Lockheed was in need of the loan guarantee in order to stave off bankruptcy. Lockheed's financial difficulties were due to losses on defense related projects, particularly the C-5A transport plane which had heavy cost overruns, and the bankruptcy of Rolls-Royce which was building engines for Lockheed's Tristar airliner. It was argued that it was essential not to let Lockheed fail since \$1.4 billion had been invested in developing the Tristar, and closing Lockheed down would cause severe unemployment in the aerospace industry, which was already hard hit by cutbacks in defense procurement and reduced airline orders.

Critics of the legislation felt it would set a precedent of the Federal government as a bailout agency for private companies in trouble. Opponents raised questions about the relationship of the Federal government to large private firms in a free enterprise economy. It was claimed the legislation really helped commercial banks which were asking Congress for guarantees in order to provide them with a risk free loan. It was argued that bankruptcy and reorganization were the mechanisms used to rectify the mistakes of poor management, and that Lockheed should go this route.

The Emergency Loan Guarantee Act of 1971, more than earlier legislation, was an effort on the part of the government to provide financial assistance to a single failing major corporation which would otherwise have gone bankrupt. The Lockheed guarantee raises the question of the relationship of business and government in an economy where business has become involved on a continuing basis in

^{1/} "Lockheed Loan Guarantee Bill Cleared on Close Votes", Congressional Quarterly 1971 Almanac, Washington, D.C., 1972, pp. 152-161.

functions which have often been thought of as wholly governmental such as national defense, space exploration, and education. When some firms, such as Lockheed, have a large percentage of their business in programs which are paid for by the Federal government, the question is raised as to how private these private firms are, and how much they are really part of the Federal government. How responsible is the Federal government for the continued survival of these firms when they do not meet contract requirements or are hurt by changes in Federal spending patterns?

Rail Reorganization Act of 1973

The Rail Reorganization Act of 1973 establishes the United States Railway Association, a non-profit, off-budget government sponsored corporation responsible for designing a restructured railroad system out of the bankrupt railroads of the northeastern United States. The legislation also creates the Consolidated Rail Corporation, a private, for-profit corporation which would run the restructured rail system.

Among other provisions of the legislation is the power of the United States Railway Association to issue \$1.5 billion in bonds, debentures, trust certificates and other obligations which would be sold to the public. These obligations would be guaranteed by the United States government. The proceeds from the sale of the obligations can be used to make loans to the Consolidated Rail Corporation and other railroads to help upgrade the new railway system, help railroads which connect with the restructured system if they are in financial trouble, and for further implementation of improved high-speed rail passenger service in the northeast corridor. At present no obligations have been issued by the association primarily because of legal problems involving the reorganization of the Penn Central Railroad.

CONCLUSION

In recent years emergency financial assistance to private firms has been primarily in the form of loan guarantees rather than direct loans. This assistance has been going to specific firms and industries, particularly railroads and the Lockheed Corporation.

The recent assistance to railroads is part of a larger history of emergency assistance, subsidies, and other types of Federal involvement. Help for railroads is perhaps a special case, even though the financial assistance has been provided to help them over a particular crisis. It is part of a continuing dilemma of how railroads should be financed, and what their relationship should be with the Federal government.

The loan guarantee program for Lockheed was Federal assistance to help a particular firm overcome a crisis. The proposal was attacked as a bailout and favoritism, and had far from unanimous support. The Emergency Loan Guarantee Act which helped Lockheed only passed the Senate by one vote and the House by three.

Pan American Airlines which in August 1974 requested an emergency Federal subsidy of \$10.2 million a month from the Civil Aeronautics Board in order to meet its financial commitments had its request rejected. The final administration decision not to provide the subsidy was made by President Ford who said that it was not fair to the nation's taxpayers to have them support international carriers like Pan Am through subsidy payments. This decision was also a reflection of substantial congressional opposition to the subsidy for Pan Am.

Proposals to create new programs to provide emergency financial assistance to private enterprise, either for a single corporation or a more comprehensive RFC type program, raise the question of who supplies emergency credit of this type. Is it a proper function of the Federal government, or is it something which

Non-Operating Programs

In addition to the above operating programs, there are others which have been authorized to provide guaranteed loans which have never been implemented. One such program is Trade Adjustment Assistance Guaranteed Loans for communities authorized under P.L. 93-618, the Trade Act of 1974. The purpose of the program is to assist communities whose economies have been hurt by imports. There is no dollar limit on the loan guarantees a community may receive. One provision of the legislation which may inhibit its use is the requirement that under certain conditions the community must pledge a portion of its next revenue sharing entitlement as loan security.

Another program, the coastal zone energy impact loan guarantee program, authorized by P.L. 94-370, the Coastal Zone Management Act Amendments of 1976, could be used by State and local governments to ameliorate the impacts of energy facility development within the coastal zone. Discussions with the National Oceanic and Atmospheric Administration indicate that only the direct loan provisions of the legislation will be used, and that no activity is expected under the loan guarantee program.